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ACCOUNTS**

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INSURANCE COMPANIES' ACCOUNTS

BY

G. H. ROBERTON

A.C.I.S., A.L.A.A.



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PREFACE

DURING the last decade various legislative measures have been enacted which directly affect both the preparation and the presentation of insurance companies' accounts, and while there are extant several books dealing with accounts of insurance companies, the fact that all were written prior to the passing of these Acts has emboldened the Author to believe an up-to-date compilation, incorporating the requirements of these Acts would be welcomed.

This treatise is written primarily for students sitting for the Chartered Insurance Institute examinations, so that a detailed exposition of all the ramifications of accountancy as applied to commercial undertakings is not deemed necessary; but as a knowledge of the fundamental principles is essential to a complete understanding of insurance companies' accounts, the first three chapters are devoted to a general outline of book-keeping and accountancy practice.

The next eight chapters deal exclusively with insurance companies' accounts, explaining how the different accounts, in which are recorded the underwriting and the investment transactions, are compiled, and taking the student step by step from the original entries in the premium and claim registers, etc., up to the preparation of the revenue accounts, profit and loss account and balance sheet, discoursing not only from the theoretical aspect but also from the practical point of view. By treating the subject in this manner it is hoped that should the student, at some future date, be faced with the necessity of applying his erudition, he will not find the task too formidable.

Having regard to the probability that the proposed Insurance Undertakings Bill, *mutatis mutandis*, will become law ultimately and to the radical changes from the Assurance Companies Act, 1909, contained therein, the last chapter contains some cursory comments on those sections of the proposed Bill which deal with accountancy matters.

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INSURANCE COMPANIES' ACCOUNTS

CHAPTER I

GENERAL PRINCIPLES OF ACCOUNTANCY

DOUBLE ENTRY SYSTEM OF BOOK-KEEPING

THE main object of any system of accountancy is to ascertain the worth of a concern at any date. This entails the recording of all transactions and, by grouping all revenue items and making the necessary adjustment for the difference in the values of the stock in hand at the beginning, and the end of the period, the amount of profit or loss applicable to the period is ascertained. The only system which adequately performs this function is that known as Double Entry Book-keeping, which, as its name implies, requires a twofold entry in the books of account for every transaction.

Every business operation has two aspects, one receiving a benefit and the other giving that benefit, both of which are recorded in the one set of books. The account that receives the benefit is debited and the account that gives the benefit is credited. If all business was conducted on a strictly cash basis it would eliminate all personal accounts and, under such conditions, it would be possible to maintain all essential records for accountancy purposes in a columnar cash book. As, however, the majority of trading concerns carry on their business on a credit basis, that is, payment is not made immediately a sale or a purchase takes place but at some future date, such additional books of account are required as will enable a trader to determine readily, amongst other things, the exact position of the personal accounts in his business.

BOOKS OF ACCOUNT

The usual books utilized for recording business dealings are (1) Day Book or—as it is sometimes called—Day Journal, (2) Bills

Receivable Book, (3) Bills Payable Book, (4) Cash Book, including the Petty Cash Book, (5) Journal, and (6) Ledger, but these may be supplemented according to the individual requirements of each trader.

The purpose for which each of these books is employed is set out *seriatim*.

(1) **Day Book or Day Journal.** There are two classes of Day Book or Day Journal, one for all credit sales and the other for all credit purchases. Such information as may be desired is extracted from the invoices or orders and recorded in chronological order in books, bound or loose-leaf. The modern practice is to dispense with books and to utilize either duplicates of the invoices and the orders themselves or to punch on to cards, suitably coded, whatever details from the invoices or orders are required. Whichever method is adopted, periodical casts of the amounts are made and in the case of the Sales Day Book, the total is debited in the General Ledger to Sundry Debtors Account and credited to Sales Account, while the individual items are debited to the respective debtors in a subsidiary Ledger. In the case of the Purchase Day Book, the entries in the General Ledger are to debit Purchases Account and credit Sundry Creditors Account with the total and, in a subsidiary Ledger, to credit the various creditors' accounts with the individual amounts.

(2) and (3) **Bills Receivable and Bills Payable Books.** In these books a trader records his transactions in bills of exchange, but before describing the books and the entries which are made therein it may be apposite to make a few remarks on bills of exchange.

A bill of exchange is defined in the Bills of Exchange Act, 1882, as "An unconditional order in writing, addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand, or at a fixed or determinable future time, a sum certain in money to, or to the order of, a specified person or bearer." As all bills of exchange have to be stamped, the definition might be amplified by deleting the opening "An" and inserting in lieu thereof "A stamped."

One advantage of drawing a bill is that it establishes the amount of the debt; thus, when a trader sells goods to a purchaser, instead of waiting for payment in cash he may arrange with the purchaser

to draw a bill of exchange upon him for the value of the goods sold. Another advantage is that the acceptance of a bill of exchange fixes a definite date for the liquidation of the debt, which the creditor may anticipate by discounting the bill and obtaining the present value thereof. As a bill of exchange is a negotiable instrument it enables a holder to transfer his property in the bill to others in settlement of his indebtedness to them. In the case of foreign trade, the use of bills obviates the necessity of remitting gold or bullion.

There are three parties to a bill, viz. the "drawer," that is the person who draws the bill, the "drawee," that is the person on whom the bill is drawn, and the "payee," the person to whom or to whose order the money is payable. No liability under the bill attaches to the "drawee" until he accepts it, when he writes his signature across the face thereof and generally the word "Accepted" followed by the name of the bank where payment will be made. The "drawee" is then known as the "acceptor" and to him the bill is a bill payable. An acceptance may be either "general" (sometimes called "clean") or "qualified," the former being one in which the acceptor assents without qualification to the order of the "drawer," while an acceptance of the second category is one which in express terms varies the effect of the bill as drawn.

Bills of exchange are either "inland" or "foreign." The latter are usually drawn in sets of three and forwarded by different mails so that should the "First" and "Second" be lost the "Third" can be negotiated, but the acceptance of any one of the three automatically voids the remainder. Bills may be drawn "on demand," "at sight," "at a fixed date," or at a number of days or months after sight or date, and by Section 14 of the Act three days' grace are allowed for payment of all bills except those payable "at sight" or "on demand."

Bills drawn to order may be transferred by endorsements to third parties, and a holder of a bill may endorse it in blank, that is, merely sign his name, or, in addition, he may state the name of the person to whom or to whose order payment is to be made, in which case it is known as a special endorsement. There is a further species of endorsement, known as a restrictive endorsement, which prohibits the further negotiation of the bill or which expresses that it is a mere authority to deal with the bill as thereby directed and

not a transfer of the ownership thereof, as, for example, if a bill be endorsed "Pay AB only," or "Pay AB for the account of C," or "Pay AB or order for collection." Where a bill has been negotiated by so many endorsers that there is not sufficient space on the back of the bill for additional endorsers to sign, a slip of paper, termed an "allonge," is pasted on to the bill for further signatures. The first endorser thereafter places his signature partly on the bill and partly on the "allonge."

When a bill is not accepted on presentation, or not paid when due, it is said to be dishonoured and immediate notice of dishonour should be given to the drawer and each endorser, while in the case of a foreign bill which is dishonoured, it should be "protested." To protest a bill a notary public makes a copy thereof and states in the protest the name of the person at whose request the bill is protested, the place and date of the protest, the cause for protesting the bill, the demand made and the answer given. Inland bills on being dishonoured are "noted," that is, a notary public makes a memorandum consisting of the date, his initials, and charges.

A trader obtaining a bill receivable can either discount it with his bank or hold it until maturity, but in either case on receipt it is entered in the Bills Receivable Book, which is ruled as shown on the next page.

From the information thus recorded Journal entries are made debiting Bills Receivable Account and crediting the personal account of the individual from whom the bill was received. Where numerous bills of exchange are involved, periodically, totals are posted to the debit of Bills Receivable Account instead of the separate items. On discounting a bill with the bank the trader makes two debit entries, one against the bank for the present value of the bill and one against Discount Account for the amount of the discount and, as the Bills Receivable Account has been relieved of the bill in question, this account is credited with the total of the two debits which will equal the original amount of the bill. Should a bill which is being held to maturity be dishonoured, the original entries will be reversed, i.e. Bills Receivable Account will be credited and the personal account debited. The personal account will also be debited with any costs for "noting" or "protesting." On the other hand, if a bill is dishonoured after being discounted with the bank, the

Bank Account will be credited with the amount of the bill, together with any costs the bank have incurred for "noting" or "protesting," and the personal account of the individual from whom the bill was received will be debited. If a bill is held to maturity and collected by the bank, the Bills Receivable Account is credited and the Bank Account debited.

When a trader accepts a bill he enters the details in the Bills Payable Book, which is ruled with the columns shown on the previous page. After being entered, the bill is returned to the person presenting it. Before the bill is due, the trader sends a "Bill Advice" to his bank, which is the banker's authority for paying the bill, provided the trader has sufficient funds with the banker. An entry is made debiting the drawer or endorser's personal account and crediting Bills Payable Account, and when the bill is paid through the bank the trader debits Bills Payable Account and credits the Bank Account.

(4) **Cash Book.** As the name indicates, this is the book in which all cash transactions are entered. Cash received is entered on the left-hand side of the Cash Book, which results in the Cash Account being debited, and conversely, cash paid away is entered on the right-hand side of the Cash Book, which automatically credits the Cash Account. In the General Ledger the double entry is completed by crediting the respective accounts with the amounts debited against them in the Cash Book and debiting the relative accounts with the amounts credited in the Cash Book. It will thus be seen that, in effect, the Cash Book is an account forming part of the Ledger, but for convenience it is always separated from the Ledger. Generally the Cash Book has additional columns for the Bank Account and Discount Account. In some businesses a columnar Cash Book is used with a separate column assigned to each account in the General Ledger which regularly contains cash transactions, and the items affecting these various accounts are entered under the respective columns, so that by casting the columns, periodical postings can be made instead of individual postings. Other businesses attain the same object by utilizing subsidiary Cash Books, bringing the totals of these subsidiary Cash Books into the main Cash Book. Where several departments or clerks post from the Cash Book, the advantages of using subsidiary Cash Books are obvious.

It is an integral part of an internal check system to deposit with the bank each day all cash received during that day and to make all payments by cheque, except small amounts which are paid out of petty cash, the replenishment of petty cash being made by a cheque drawn on the bank.

Petty Cash Book. In this book are recorded all small payments together with the amount of the replenishment cheques. It is usually in columnar form and the replenishment cheques are entered in the debit column, while the various payments for expenses, etc., are entered in their appropriate credit columns. The totals of these credit columns are posted periodically to the relevant "Expenses" accounts, etc., in the General Ledger.

There are two methods of controlling petty cash, one known as the "Imprest" and the other as the "Fixed Replenishment" system. The procedure in the former case is to give the petty cashier a sum sufficient to meet all petty expenses for a period and, at the end of such period, to recoup him with a cheque for the total amount expended, so that at the beginning of each period he has the same sum in hand. In the other case cheques for pre-determined fixed amounts are handed to the petty cashier whenever the petty cash balance is depleted sufficiently to warrant replenishment.

(5) **Journal.** In the pioneer days of double entry book-keeping it was the practice to pass all transactions through the Journal and to post these, item by item, from the Journal to the Ledger, but the expansion of business has made such a procedure somewhat cumbersome and impracticable, consequently the Journal nowadays is divided into a number of subsidiary Journals such as the Sales Day Journal, Purchase Day Journal, etc., and only the totals of these subsidiary Journals are posted to the General Ledger, while the "Journal proper" is reserved for the opening and closing entries and for any adjustments. The "Journal proper" is ruled with two cash columns on the right-hand side of the page, the first column being for items to be debited and the second for those to be credited. The account to be debited is written first and the amount extended in the first or debit column, the explanation of the entry (which is called the "narrative") follows underneath, and then comes the account to be credited, preceded by the word "To" and the amount applicable thereto extended to the second or credit

Dec.	31	Fire Premium Account To Fire Revenue Account	Being the net premiums for the year transferred	Dr	62	£ 100,000	s.	—	d.	—
				Or	68	100,000				—
Dec.	31	Fire Premium Account To Fire Revenue Account	Being the net premiums for the year transferred	Dr.	62 68	100,000				—
						100,000				—

column. The practice varies; sometimes the account to be credited follows immediately after that to be debited, in which case the narrative will come last. On the previous page is set out a ruling for a Journal.

(6) **The Ledger.** This is a trader's principal book, in which all his transactions are gathered together in the form of accounts. In a small business all accounts may be contained in the one Ledger, but where this is not practicable it is advisable to have subsidiary Ledgers with a total or control account for each subsidiary Ledger in the General Ledger. The title of the principal Ledger of a business varies with different concerns, the more common designations being "general," "main," "private," etc., but throughout this work it will be referred to as the "General Ledger."

CHAPTER II

GENERAL PRINCIPLES OF ACCOUNTANCY (CONTD.)

KINDS OF ACCOUNTS

ALL accounts may be divided broadly into two classes, namely, Personal and Impersonal.

Personal accounts are those relating to the persons, firms, and companies with whom the trader has dealings. Each account contains a record of all the trader's business transactions with such party, and should the balance of a personal account be a debit one, representing an amount owing to the trader, it would be shown on the asset, or right-hand, side of the Balance Sheet under the heading "Debtors," while should the balance be a credit one it would appear on the liability side of the Balance Sheet under the heading "Creditors" and would represent an amount owing by the trader.

All other accounts may be classified as Impersonal accounts and relate to the property, the gains and the losses of the trader. They may be subdivided into Real and Nominal accounts. The former deal with the various forms of property possessed by the trader, while the latter deal with his income, gains, losses, and expenses. It naturally follows from this explication of Real accounts that the balances of such accounts are practically always debit ones, that is assets, but should there be a credit balance on a Real account it would indicate that a profit on the sale of the property had materialized which had not been taken out of the account. If the balances of Nominal accounts are debit balances they will represent either losses or expenses; on the other hand, if they are credit ones they will indicate income, gains, or profits.

From the foregoing exposition one of the fundamental rules of double entry book-keeping is disclosed, viz. that a debit balance denotes an asset, a loss, or an expense, and a credit balance a liability, a profit, a gain, or an income.

DISTINCTION BETWEEN CAPITAL AND REVENUE EXPENDITURE

It is important that the distinction between capital expenditure and revenue expenditure should be appreciated, as the incorrect treatment of either distorts the true profit or loss for the period. The following definitions will enable the student to distinguish clearly between them. Capital expenditure may be defined as that which is incurred for the purpose of acquiring assets of a permanent nature by means of which the business is enabled to function or for the purpose of increasing the earning capacity of the business. Revenue expenditure is that which is incurred in carrying on the business and in maintaining the capital assets in a state of efficiency.

TRIAL BALANCE

Arising out of the fact that in double entry book-keeping every debit must have a corresponding credit, it follows that, if all the postings have been correctly made, the total of the debits in the General Ledger will equal the total of the credits, thus proving the arithmetical accuracy of the postings. The method whereby this test is accomplished is known as "taking out a Trial Balance." The Trial Balance statement generally provides for the Ledger folio, the title of the account, and two cash columns, the first column for debit balances and the second for credit balances. The debit items and the credit items of each individual account in the General Ledger are totalled and the balance, or difference, entered on the statement in the appropriate column. If the total of the debit items in an account exceeds the total of the credit items, the balance will be a debit one, while should the credit total exceed the debit total the balance will be a credit one. In compiling the Trial Balance it must not be forgotten that the Cash Book is nothing more or less than the "Cash" account, which for convenience is separated from the General Ledger, and the balance thereof must therefore be included in the Trial Balance, as also must any petty cash in hand, if the account is not maintained in the General Ledger.

ERRORS IN THE TRIAL BALANCE

If the totals of the debit and credit columns of the Trial Balance statement are not in agreement, the discrepancy should be located

by checking the additions of the Trial Balance; if this does not reveal the error, the General Ledger balances should be examined to see that they have all been included and that in extracting them on to the Trial Balance statement they have not been placed in the wrong column, that is, a debit balance entered in the credit column or vice versa. Should the difference still remain undisclosed it would be advisable to see that the totals of all the subsidiary journals have been properly included and, if so, it would then be necessary to check the additions of the accounts in the General Ledger. If all these tests fail to discover the error, the onerous task of checking in detail all the postings to the General Ledger would have to be resorted to, special care being taken to see that debit items have not been posted as credits or vice versa. The fact that the two columns of the Trial Balance are in agreement does not prove conclusively the accuracy of the recording of the transactions, as the following errors would not be revealed—

1. Omission of entries. This would arise where both the debit and credit entries appertaining to a transaction were omitted.

2. Compensating errors. These are cases where an amount over-debited in one account is compensated by a similar amount over-credited in another account.

3. Misposting of accounts. In such cases the correct amount would be posted to the wrong account, e.g. £100 debited to the account of John Jones instead of to the account of James Jones.

4. Errors of principle. This is where entries are made in the wrong class of account, e.g. posting a revenue item to a Real account.

While the primary object in taking out a Trial Balance is to test the arithmetical accuracy of the accounts, it also serves as a basis for preparing the Profit and Loss Account and the Balance Sheet.

ADJUSTMENTS BEFORE CLOSING THE BOOKS

In order to arrive at the true results of a trader's operations it is necessary to make sundry adjustments before closing the books for the year. Various charges will have accrued at the end of the year which will not have been paid, while, on the other hand, certain expenses will have been paid in advance. These items must be apportioned to their proper accounting periods. As an example of

an expense which has accrued at the end of the year but which has not been paid by the time the books are closed, let us assume that rent is payable quarterly—not in advance—on the 1st January, April, July, and October, and the trader closes his books on the 31st December. At this date three months' rent will have accrued due but **will** not have been paid; a Journal entry, therefore, is made debiting Rent Account with the quarter's rent and crediting a Reserve Account. The Rent Account, which will have been debited with the payments made on the 1st April, July, and October and also with the above entry, will represent a full year's rent and **will** be closed by transferring the balance to Profit and Loss Account, while the Reserve Account will be brought down as a balance to the following year and will be shown as a liability in the Balance Sheet. When payment is made on the 1st January it will be debited to Reserve Account and not to Rent Account. Instead of opening a Reserve Account for such items there is a common practice of making the entry for the rent due on the 1st January to the debit of Rent Account and to bring down the item as an opening entry on the opposite side of the account for the following year; the effect is just the same but the Journal entry is to debit the current year's Rent Account and to credit the following year's Rent Account. If this procedure is adopted it must be remembered to bring the latter item, which is shown in the Ledger as applying to the following year, into the current year's Trial Balance, otherwise the Trial Balance will be out of agreement by the amount of this entry, and further, when the payment is made on the 1st January it must be debited to Rent Account, so that immediately the posting is made from the Cash Book the Rent Account will be all square. Taking an example of a payment made in advance, we can instance rates, which are generally levied for the year ending 31st March and paid before the preceding 31st December, so that if the trader's accounts are made up to the 31st December he will have charged his accounts with the full year's payments, whereas only three-quarters of that year's rates should be debited, as the final quarter of the rates for the previous year will have been debited already in this year's accounts. In order to make the necessary adjustment a Journal entry is created crediting Rates Account in that year and either debiting an account for "Amounts paid in advance" or

bringing the item down as a debit to Rates Account in the following year. In either case the item is shown in the Balance Sheet on the asset side.

The student must bear in mind that all items in the Trial Balance before making any adjustments have had their corresponding debits or credits accounted for and, consequently, when preparing the Profit and Loss Account and Balance Sheet they must appear only once. As the entries in connexion with items for which adjustments have to be made have not been passed through the books they will be taken into consideration twice, once in the relevant revenue account and once in the Balance Sheet, either as an asset or as a liability.

At the end of the financial period, after the Trial Balance has been extracted and agreed and all adjustments made, the Real and Personal accounts are balanced and the balances brought down, the debit balances being shown in the Balance Sheet as assets, and the credit balances as liabilities. The balances in the Nominal accounts are transferred by Journal entry to the Profit and Loss Account, the debit balances being shown on the debit side of the Profit and Loss Account and the credit balances on the credit side. The only entry then required to complete the trader's books is the value of his stock in hand, and when this is ascertained the amount is debited by Journal entry to Stock Account and credited to Profit and Loss Account. It is generally stated that stock in hand should be valued at cost or market price, whichever is the lower. Unfortunately this phrase is capable of various interpretations, but the maxim emerges from the few cases that have been considered in the Courts that the same definite method of valuation should be consistently adhered to from year to year.

PROFIT AND LOSS ACCOUNT

To ascertain the result of the trading operations for the period, an account is created into which the balances of the Nominal accounts are posted. This account is called a Profit and Loss Account, or Revenue Account or Income and Expenditure Account according to whether the concern is an ordinary commercial undertaking or one whose principal income is derived from investments or is a non-trading concern.

Many commercial undertakings divide their Profit and Loss Account into three sections, the first called the Trading Account, the second the Profit and Loss Account, and the third the Appropriation Account. The Trading Account is debited with the value of the stock at the commencement of the period, the debit balance of the Purchases Account, and, in the case of a manufacturing business, the prime cost charges, and credited with the credit balance of the Sales Account and the value of the closing stock. The balance of the Trading Account is the gross profit or loss on trading, which is carried to the Profit and Loss Account. This latter account is credited with other items of profit and debited with the expenses of distribution and the expenses of management. The balance of the Profit and Loss Account represents the net profit or loss which is credited or debited, as the case may be, to the Appropriation Account, which latter account will include any balance brought forward from the previous period, and will reveal how the net profit and the balance brought forward are to be disposed of.

So far as non-trading undertakings are concerned, it will be found that some show their results for the accounting period by preparing an Income and Expenditure Account, while others issue a Receipts and Payments Account. The difference between these two kinds of accounts may be summarized as follows—

<i>An Income and Expenditure Account</i>	<i>A Receipts and Payments Account</i>
Includes the actual income earned and the expenditure incurred for the period.	Includes only the actual income received and the actual expenditure paid away during the period.
Includes revenue items only.	Includes both capital and revenue items.
Includes income on the credit side and expenditure on the debit side of the account.	Includes cash received on the debit side and cash paid away on the credit side.
The balance represents the excess of income over expenditure or vice versa.	The balance represents the cash in hand.

From the above characteristics of Income and Expenditure Accounts and Receipts and Payments Accounts it will be evident that any trading concern, having undischarged liabilities at the end of the period, or assets other than cash, cannot show its true trading results by the compilation of a Receipts and Payments Account.

BALANCE SHEET

After compiling the Profit and Loss Account, the open accounts remaining in the General Ledger, including the balance of the Profit and Loss Account, constitute the items in the Balance Sheet and consist of—

1. Assets, such as real or property accounts, sundry debtors accounts, cash and bank balances, adjustment of nominal accounts, such as payments in advance, etc.

2. Liabilities, such as Capital Account, sundry creditors accounts, reserve accounts, and adjustment of nominal accounts such as accrued expenses.

The object of a Balance Sheet is to show the financial position at a given date, and it may be defined as a classified summary of all the balances standing in the books, after transferring the balances of all nominal accounts to one account, called the Profit and Loss Account, and including the balance of that account. The open accounts are then arranged so as to show the assets on the right-hand side and the liabilities on the left-hand side.

In the Balance Sheet of a commercial business the fixed assets are placed first, followed by the floating assets, whereas in that of a financial undertaking the assets are generally placed in their order of realizability. The modern tendency inclines to grouping the assets and liabilities, showing sub-totals under the headings Fixed Assets, Current Assets, and Intangible Assets, and on the liability side Share Capital, Reserves and Undistributed Profits under one sub-total, followed by Debentures, Mortgages and Secured Loans under another sub-total, and, finally, Current Liabilities. This method enables one to see at a glance how the current assets compare with the current liabilities—a most important factor in assessing the financial stability of a company.

CLASSIFICATION OF ASSETS

Assets may be classified under the following headings—

Fixed Assets. These are assets of a permanent nature by means of which the business is carried on and which are held for the purpose of earning income and not for the purpose of sale, e.g. land, buildings, plant, machinery, etc.

Wasting Assets. These are assets which are gradually consumed in the process of earning profits, such as quarries, mines, etc.

Floating or Circulating Assets. These are the assets in which the business deals and which are required for the purpose of sale and subsequent conversion into cash, e.g. stock in trade, book debts, bills receivable, etc.

Fictitious Assets. These are items which consist of expenditure unrepresented by any tangible assets, but which remain as outstanding debit balances after closing the books, e.g. expenditure spread over a term of years, such as preliminary expenses.

Liquid Assets. These are assets which can be converted readily into cash, e.g. gilt-edged securities.

Frequently assets which are "Fixed" in connexion with one business may be "Floating" in the case of another business.

DEPRECIATION

When all the postings have been made from the Cash Book and the various Journals into the General Ledger, it will be apparent that, with the exception of the stock in hand, the assets appear in the Balance Sheet at their cost price, but certain of these assets, at the date of the Balance Sheet, will have deteriorated in value due to depreciation, and in order that the Balance Sheet may reflect a true state of the financial position, provision should be made for this depreciation.

Depreciation is the diminution in value of an asset as the result of wear and tear and gradual obsolescence, and, being a loss incident to the possession and the use of the assets, it should be charged against the profits as a working expense before arriving at the balance of divisible profits. It may be mentioned that machinery often becomes obsolete owing to the progress of invention long before it is worn out.

FLUCTUATION

This is an accidental variation in the value of the assets, which is attributable to causes apart from the business itself. Any increase in the value of fixed assets due to fluctuation may be regarded as a secret reserve and any such increase in the value of the floating assets represents temporarily a secret reserve which, if still existing

when the assets are realized, will be included in the trading profits for that period. Any decrease in value due to fluctuation, if of a temporary nature, may be ignored, but if of a permanent character, provision should be made at the time the decrease occurs rather than at the time the assets are realized.

Many cases have been brought before the Courts to determine whether it is legal to pay dividends out of profits before making provision for depreciation. The aggregate result of the decisions in these cases is that while "Floating" or "Circulating" assets must be adequately depreciated, there is no necessity to write off depreciation of "Fixed" or "Wasting" assets before paying a dividend. Notwithstanding this legal maxim, the prudent commercial man provides for the depreciation of all classes of assets.

The method adopted for writing off depreciation is to debit the trading account and to credit either the account of the asset or a depreciation account.

METHODS OF PROVIDING FOR DEPRECIATION

There are six principal methods of providing for depreciation, viz.—

The Fixed Instalment System. The procedure under this system is to write off each year, by debiting the revenue account, an amount which is calculated as a fixed rate per cent on the *original cost* of the asset and which will reduce the value of the asset by the end of its life to break-up value. Repairs and small renewals are charged to revenue. The objection to this method is that in the later years, when the charge for repairs and renewals naturally increases, the total amount debited to revenue is heavier compared with the earlier years.

The Reducing Instalment System. This system is applied to plant, fixtures, furniture, etc. A fixed rate per cent on the *diminishing value* of the asset is written off each year and debited to revenue account so as to reduce the asset by the end of its life to break-up value. Also, under this system repairs and small renewals are charged to revenue. While this method has not the disadvantage referred to in the fixed instalment system, a much higher rate per cent has to be used in order to bring the value of the asset down to break-up value by the end of the period and, consequently, the revenue account in the earlier years may be debited with too large

an amount and with too small an amount in the later years, even after taking into consideration the increased charges for repairs and small renewals in these later years.

The Annuity System. This system, which is applied to leases, regards the asset as earning a fixed rate of interest each year on the *diminishing value*; such interest is debited to the asset account and credited to revenue account, and a fixed amount is written off each year and debited to revenue account so as to reduce the value of the asset to nil at the end of the period. It is the most scientific system when investment is not desired outside the business, but the objection to it is that while the amount debited to revenue is constant the credit to the revenue account decreases each year due to the interest on the asset diminishing.

The Sinking Fund System. Under this system a fixed proportion of the original cost is debited each year to revenue account and credited to Sinking Fund Account, and an equivalent amount of cash is invested outside the business in gilt-edged securities and allowed to accumulate at compound interest, so that at the end of the period the amount required is produced. At the end of the period the balance of the Sinking Fund Account is transferred to the credit of the asset account, which should then be nil. The securities are realized and the proceeds utilized to purchase the new asset. The objection to this method is that owing to the low rate of interest at present obtainable from gilt-edged securities, the money might be more beneficially employed in the business itself, and also the possibility of there being a loss on realization of the security. On the other hand, this method avoids any disturbance of the financial position when replacement becomes necessary. This system is applied to those cases where it is necessary to replace the asset at the end of its life from moneys provided outside the business.

The Insurance Policy System. This system is applied in similar cases to those under the Sinking Fund system. An endowment policy or redemption assurance policy is taken out for a sum sufficient to produce the amount required at the end of the period. The treatment is similar to that adopted in the case of the Sinking Fund system, but instead of the equivalent money being invested in gilt-edged securities it is used to pay the premiums on the policy. It is customary to maintain the Policy Account at the surrender value

by crediting the Policy Account and debiting the Sinking Fund Account. When the policy matures the amount received will be in excess of the amount standing to the debit of the Policy Account. This profit is debited to Policy Account and credited to Sinking Fund Account. The objection to this method is the low rate of interest earned on the policy moneys, but there can be no loss on realization such as is possible under the Sinking Fund system.

Revaluation. The asset is revalued at the end of the year and the amount of depreciation written off to the debit of revenue account. Should the revaluation disclose an appreciation, due to additions which have been charged to revenue, the appreciation should be credited to revenue account, but should the appreciation arise from any other cause it would be of a capital nature and could be regarded either as a secret reserve or placed to the credit of a Special Reserve Account. The objections to this system are the labour involved and the unequal charge to revenue account each year due to the market fluctuations of such assets. If the cost of repairs in any one year is exceptionally heavy, only a portion is debited against that year's revenue and the balance is carried in a "Suspense" account to be written off over future years. This method is applied in the case of loose tools, patents, copyrights, live stock, plant, etc., which rapidly depreciate.

RESERVES AND RESERVE FUNDS

Considerable confusion is caused by the indiscriminate use of the terms "Reserves" and "Reserve Funds," but the distinction in principle will be recognized from the following definitions—

A Reserve is a provision *charged against profits* to provide for a *known but unascertained loss*.

A Reserve Fund is an amount *set aside out of profits* to meet any *unknown or unexpected liabilities*.

The former is sometimes referred to as a Specific Reserve, in which case the latter would be known as a General Reserve. It is customary to show a Reserve or Specific Reserve on the right-hand side of the Balance Sheet as a deduction from the asset affected, while a Reserve Fund or General Reserve is shown as a separate item on the left-hand side of the Balance Sheet as a liability. From the foregoing definitions it will be appreciated that it is impossible

to create a Reserve Fund or General Reserve except out of divisible profits, whereas a Reserve or Specific Reserve must be established notwithstanding the trading has resulted in a loss. As a Reserve Fund or General Reserve is provided out of divisible profits, should the Profit and Loss Account, on some future occasion, show a debit balance it would be necessary to transfer an equivalent amount from the Reserve Fund or General Reserve to the credit of the Profit and Loss Account. In other words a Reserve Fund or General Reserve is nothing more or less than a part of the Profit and Loss Account balance, and, therefore, it would be a violation of the fundamental principles of accountancy to publish a Balance Sheet showing a debit balance on the Profit and Loss Account in conjunction with a Reserve Fund or General Reserve.

SINKING FUNDS

A Sinking Fund is a fund set aside for some particular purpose and specifically invested. Dependent upon the object for which the fund is created, the amounts set aside will be either a charge on the profits or an appropriation of profits. The distinction between a "charge on" and an "appropriation of" profits is that in the former the debit against revenue will be made irrespective of whether the trading results disclose a profit or not, whereas in the latter the debit would be made only in the event of a profit emerging from the trading transactions. If the fund is inaugurated for the purpose of redeeming a liability, the annual amount set aside will be an appropriation of profits, but if the fund is raised to provide for the wastage of an asset the annual instalment will be a charge on the profits. When a Sinking Fund has been created to redeem a liability, on the liability falling due for payment, the investments comprising the fund will be realized and the proceeds resulting therefrom will be utilized to meet the liability, while the Sinking Fund itself will become an ordinary Reserve Fund or General Reserve. In the case of a Sinking Fund created to provide for the wastage of an asset, when the lifetime of the asset has expired, the balance of the Sinking Fund will be transferred to the asset account, and, as a result, both the Sinking Fund and the asset will disappear, while the specific investments which have been purchased will take the place of the original asset.

SECRET OR HIDDEN RESERVES

As their name implies, these are provisions or reserves which are not disclosed on the face of the Balance Sheet. They may be established by (1) writing down assets below their intrinsic value, (2) making excessive provisions for Bad Debts, Discounts, etc., (3) charging items which are of a Capital nature to Revenue expenditure. The advantage claimed for the practice of setting up secret reserves is that it enables dividends to be maintained without violent fluctuations. The argument against secret reserves is that in those years in which they are created or augmented the accounts will reflect a weaker state of affairs than is actually the case, while in those years in which the secret reserves are brought back into the accounts the results will appear better than they genuinely are. It is claimed that the opportunity of thus manipulating the profits is a grave temptation to the directors to have improper dealings in the shares. The general consensus of opinion now is that the utilization of secret, or hidden reserves, either to relieve losses or to increment profits, should be indicated to the shareholders and, except in comparatively rare cases, the amount so used should be stated.

CONTINGENT LIABILITY

There are certain transactions which give rise to a liability only on the happening of a contingency and should the accounts contain any items of this nature, a note of such contingent liability should be made at the foot of the Balance Sheet, so that its existence may be apparent. The contingent liability appertaining to shares with uncalled liability and to discounted bills receivable are amongst the most frequently quoted cases. Anent the former the liability extends for a period of twelve months after the sale of such shares owing to the possibility of the vendor being placed on the "B" List of Contributories.

ARREARS OF CUMULATIVE PREFERENCE DIVIDENDS

Notwithstanding preference shares being designated cumulative, holders are not entitled to any dividends until they are declared by the company, the amount of the dividend not being a debt due from the company until such declaration, but if there are any such dividends in arrear a note thereof should be made at the foot of the Balance Sheet.

CHAPTER III

GENERAL PRINCIPLES OF ACCOUNTANCY (CONTD.)

WHEN two or more persons combine to carry on business, the combination usually takes the form of either a partnership or a company.

PARTNERSHIP UNDER THE PARTNERSHIP ACT, 1890

A partnership is defined in the Partnership Act of 1890 as the relation which subsists between persons carrying on a business in common with a view to profit. The Act restricts the number of persons who may carry on a partnership for ordinary business to twenty, and in the case of a banking business the number is limited to ten. The rights and duties of the partners regarding the contributions to capital, the distribution of profits and the control of the business are provided for in the partnership agreement, but, where the agreement is silent on the subject, the Partnership Act lays down the conditions which must apply. The book-keeping procedure, subject to the treatment of the capital and profits, is identical with that of a sole trader.

COMPANIES INCORPORATED UNDER THE COMPANIES ACT, 1929

A company may be incorporated under the Companies Act, 1929, or by special Act of Parliament, or by Royal Charter. By far the largest number of companies extant are those incorporated under the Companies Act, 1929, and such companies may be (a) limited by shares, that is the liability of each individual member is limited to the amount unpaid on the shares held by him, or (b) limited by guarantee, that is each individual member's liability is limited to the amount he has undertaken to contribute in the event of the company winding up, or (c) unlimited, in which case the liability of each individual member for the debts of the company is unlimited; but there are few in number of the latter kind.

PUBLIC AND PRIVATE COMPANIES

Of the companies incorporated under the Companies Act, 1929, those limited by shares are the most numerous and important. They are divided into two classes, public and private, the latter being those which, in accordance with Section 26 of the Act, must by their Articles of Association, restrict the right to transfer their shares, limit the number of their members (exclusive of past and present persons in the company's employment who are members) to fifty, and prohibit any invitation to the public to subscribe for any of their shares or debentures. Further, under Section 1 of the Act the minimum number of members permitted for a public company is seven, while the minimum number for a private company is two. The chief advantage of registering as a private limited company is that the company is relieved of the necessity for complying with certain regulations in the Companies Act, 1929, which are obligatory in the case of a public limited company.

MEMORANDUM OF ASSOCIATION

In the case of companies incorporated under the Companies Act, 1929, the object for which the company is formed and its powers are contained in the company's Memorandum of Association, which consists of six essential clauses, as follows—

1. The name of the company with the addition of the word "Limited" as the last word of the name.
2. The situation of the company's Registered Office.
3. The objects for which the company is formed.
4. A declaration that the liability of the members is limited.
5. The amount of the company's capital and the number and the value of the shares into which the capital is divided.
6. The Association Clause, which runs: "We are desirous of being formed into a company and we respectively agree to take the number of shares set opposite to our respective names."

It will be realized that clause No. 4 applies only in the case of companies which are limited by shares or by guarantee, and that as regards clause No. 5, this applies to all companies having a share capital, but not to companies the liability of whose members is

unlimited. A company's Memorandum of Association constitutes the contract between the company and the outer world.

ARTICLES OF ASSOCIATION

The rules and regulations governing the management of a company and the powers of the directors are contained in the Articles of Association. The first schedule to the Companies Act, 1929, is a model set of Articles called "Table A," which are applicable to all companies limited by shares which have not Articles of their own or whose Articles do not modify or expressly exclude "Table A" (Section 8). A company's Articles of Association constitutes the contract between the company and its members.

STATUTORY BOOKS

Every company incorporated under the Companies Act, 1929, must keep (in addition to the books of account required by Section 122 of the Act) the following Statutory Books—

1. Register of Members. (Section 95.)
2. Register of Mortgages. (Section 88.)
3. Register of Directors or Managers. (Section 144.)
4. Annual Return. (Section 110.)
5. Minute Book. (Section 121.)

With perhaps the exception of the Annual Return, the books are self explanatory. The Annual Return contains *inter alia* a list of all shareholders, together with the amount of their holdings, their addresses and descriptions. A copy signed by a Director, the manager or the secretary must be deposited at least once in every year with the Registrar of Companies.

CAPITAL OF A COMPANY

The necessary cash to enable a public company to function is obtained through applicants completing a form of application and returning it, together with the requisite remittance, to the company or to the company's bankers. A form of application containing an invitation to subscribe for shares is incorporated with the prospectus which the company issues. Usually only a portion of the total value of each share is payable with the application, a further portion

being payable on allotment and further proportions on future dates when called. The amount of capital set out in the Memorandum of Association and which the company has power to issue, and on which it has paid stamp duty, is known as the nominal or authorized capital. The amount of capital issued for subscription and allotted to the members is known as the subscribed or issued capital. The amount actually paid up on the issued shares is known as the paid up capital, and the amount not yet called up is known as the uncalled capital. Sometimes companies, principally banks, pass a special resolution to the effect that the uncalled capital can only be called up in the event of the winding up of the company. Such procedure is permitted by Section 49 of the Act, and the uncalled capital is then known as "Reserve Capital" or "Reserve Liability."

STOCKS AND SHARES

The capital structure of a company limited by shares may be either shares or stock. The fundamental distinction between shares and stock is that the latter must be fully paid up while the former may be either fully or partly paid up; also, stock may be transferred in fractional parts, subject to any limitation imposed by the company's Articles, whereas shares can be issued and transferred only in their entirety. The Companies Act, 1929, Section 50, allows a company limited by shares, provided its Articles of Association permit, to alter the conditions of its Memorandum so that, *inter alia*, it may convert all or any of its *paid up* shares into stock, and reconvert such stock into paid up shares. One of the primary reasons for converting shares into stock is to circumvent the legal obligation of maintaining distinctive numbers of shares.

KINDS OF SHARES

The various kinds of shares, with the rights attaching thereto, are indicated below—

Ordinary shares generally carry no special privileges as regards the sharing of profits or the distribution of assets in the event of winding up.

Preference shares carry certain preferential rights either to dividend or to the distribution of assets in the event of winding up,

or both, but they are not deemed to be preferential as to capital unless express stipulation to that effect is contained in the Articles of Association. Preference shares may be either cumulative or non-cumulative, but unless distinctly stated to the contrary in the Articles of Association all preference shares are cumulative. Both classes usually carry a fixed rate of dividend, but in the case of the cumulative, should the profits in any year be insufficient to pay the dividend, the arrears must be made good out of subsequent years' profits before any dividends can be paid to the ordinary shareholders. As regards the non-cumulative, they are not entitled to have the deficiency in the dividend in any year made up out of future years' profits.

Deferred shares usually carry no right to a dividend until the dividend on the preference shares and not less than a predetermined percentage for the ordinary shares have been allotted out of the profits.

Founders' shares generally entitle the holders to the whole or a definite portion of the profits remaining after allocating dividends at certain fixed rates on other classes of shares. These shares are usually issued to the vendors or promoters of companies as part of their consideration, and as a rule are few in number.

DEBENTURES AND DEBENTURE STOCK

Supplementary to raising money by the issue of shares, companies frequently raise money by borrowing, and a very common form of borrowing is on security of debentures. Generally speaking, any trading or commercial company has an implied power to borrow even if its Memorandum and Articles of Association are silent on the subject, but if the company adopts "Table A" for its Articles it cannot borrow in excess of its issued share capital without the sanction of the company in general meeting. A debenture is a written acknowledgment of a debt by a company under its seal, and usually contains provisions as to the payment of interest and the repayment of principal. Debentures are known by different names according to whether the payment is secured by a charge or not, and, if by a charge, whether it is a "fixed" or "floating" one. Simple or naked debentures give no charge on the assets of the company. Floating debentures give an equitable charge on

some or all of the assets of the company. Mortgage debentures give a fixed charge upon certain specified assets of the company. It is customary for trustees to be appointed for the debenture-holders to hold the deeds of property and/or securities mortgaged and generally to protect the interests of the debenture-holders.

Debenture stock is of the same nature as ordinary debentures, except that, instead of each bond securing a definite amount, the whole sum secured is treated as a single stock and certificates are issued declaring the holder to be entitled to a part of the stock. Debenture stock is transferable in fractional parts, whereas a debenture can be transferred only in total. Both debentures and debenture stock may be issued either in "redeemable" or "irredeemable" (sometimes called "perpetual") form, it being generally understood by "irredeemable" that, provided the terms of the loan are complied with and the security is not in jeopardy, the debenture-holder has no power to demand payment although the company may redeem the debentures or debenture stock at its option, subject to notice.

GEARING OR LEVERAGE

In British financial parlance the term "gearing" is used to denote the relationship existing between rigid capital, i.e. fixed interest bearing, such as debentures and preference shares, and flexible capital, i.e. ordinary or equity shares, the American synonym being "leverage." The capitalization is referred to as being "high geared" when the debentures and/or preference shares constitute a large percentage of the total issued capital, "low geared" when the percentage is small, and "non-geared" when the capital consists entirely of ordinary shares.

DIFFERENCE BETWEEN ACCOUNTS OF TRADERS, PARTNERSHIP, AND LIMITED COMPANY

So far as the book-keeping is concerned, the same principles are applicable to all, but the treatment of the Capital Account and the appropriation of the profits varies according to the character of the business.

The Capital Account of a limited company remains constant from year to year, unless the company makes a new issue or calls up some uncalled capital or reduces its capital. The Capital

Accounts of a partnership may or may not alter yearly, dependent entirely upon the terms of the partnership agreement. The Capital Account of a trader is increased by the transfer of his profits and reduced by his losses and his personal "drawings."

Very rarely are the whole of the yearly profits of a limited company distributed in the form of dividends to shareholders. It is the practice to carry forward a balance to the following year, and/or to transfer part of the profits to reserve. In the case of a partnership, subject to the terms of the partnership agreement, the total profits are divided amongst the partners, and in the case of a sole trader the whole of his profits are transferred to his Capital Account.

RECORDING OF CAPITAL SUBSCRIPTIONS

Accompanying the prospectus inviting subscriptions for shares are forms of application addressed to the company's bankers. An applicant desiring to become a member of the company completes the form and returns it to the company's bankers together with his remittance for the amount payable on application on the shares applied for. The company enters in a subsidiary book, called the Applications and Allotments Book, the following details extracted from these forms, the name, address, occupation of each applicant, the number of shares applied for and the amount of the deposit paid. On an allotment being made, the number of shares allotted to each applicant and the amount payable in connexion therewith are inserted in the respective columns, but where no allotment is made, the amount returnable to the applicant is entered in the column provided. To those persons who have been allotted shares, an allotment letter is dispatched, giving the number of the shares allotted and requesting payment of the amount due.

From the Applications and Allotments Book the individual items are posted to the Share Ledger, which is a subsidiary ledger, and in which each shareholder has a separate account opened for him. The total amount payable on application and allotment as shown by the Applications and Allotments Book is posted in the General Ledger to the debit of Applications and Allotments Account and to the credit of Share Capital Account. If there are more than one class of shares, separate accounts are opened for each class.

From the Bank Pass Book each item is posted in the Share Ledger

to the credit of the individual applicant. The Bank Account is debited with the total of the amounts paid in by the applicants, and the double entry is completed by crediting the Applications and Allotments Account. Thus if all allotments have been paid there will be no balance on the Applications and Allotments Account and the Share Capital Account will show the total amount paid up, but if some of the applicants have not paid the amounts due on allotment the balance on the Applications and Allotments Account will agree with the total of the amounts outstanding according to the Share Ledger.

When a call is made a similar procedure is followed; a Call Account is opened in the General Ledger and debited, by means of a Journal entry, with the total amount of the call, while Share Capital Account is credited with a like amount. The Bank Account is debited with the total of the calls received and the Call Account credited.

As the individual entries in the Share Ledger do not form an integral part of the double-entry system, it will be apparent that the transfer or transmission of shares has no effect on the company's Capital Account.

SHARES ISSUED AT A PREMIUM

Frequently shares are issued at a premium, that is, at an amount in excess of their par value, and in such cases, it is customary to include the amount of the premium with the amounts payable on application and on allotment. The amount of the premium is credited to Share Premium Account and, as such, is often utilized for writing off preliminary expenses, goodwill, etc.

SHARES ISSUED AT A DISCOUNT

Prior to the passing of the Companies Act, 1929, it was illegal to issue shares at a discount, and as a consequence it was not practicable for a company whose shares were valued below "par" to attempt to make a further issue of the same class. However, Section 47 of the Act has remedied this, subject to the following provisions—

1. The shares which are to be issued are of a class already issued.

2. The issue must be authorized by a resolution passed at a general meeting and must be sanctioned by the Court.

3. The resolution must specify the maximum rate of discount at which the shares are to be issued.

4. At least one year must have elapsed since the company was entitled to commence business.

5. The shares must be issued within one month after the sanction by the Court (this period may be extended by the Court).

Where such an issue takes place the method of recording the transactions is to credit Share Capital Account with the nominal value of the shares and to debit (a) the Bank Account with the actual cash received and (b) the Discount on Issue of Shares Account with the amount of the discount. The latter account should be written off out of profits as soon as possible, and the balance of this account must be shown in every Balance Sheet issued by the company and in any subsequent prospectus until finally written off.

DEBENTURES ISSUED AT A PREMIUM ; DEBENTURES ISSUED AT A DISCOUNT

The restriction on making an issue at a discount never applied to debentures, but the canons of accountancy require the amount of the discount to be shown in the Balance Sheet as a separate item. Except for the obvious alterations in the appellation of the accounts, the book-keeping entries necessary for recording these transactions are similar to those outlined above for shares.

FORFEITED SHARES

Power is usually given to the Directors in the Articles of Association to forfeit shares in respect of which calls are unpaid and overdue, but before forfeiture takes place notice must be given to the defaulting shareholder. The book-keeping procedure on forfeiture is to debit Share Capital Account with the total amount called up in respect of the forfeited shares and to credit Forfeited Shares Account. The Forfeited Shares Account is then debited with the value of the calls in arrear, and the Call Account credited with the same amount, so that the credit balance of the Forfeited Shares Account will represent the actual cash received on account of the forfeited shares, while the Share Capital Account will show the

amount of the shares actually taken up and the Call Account will be square. In the Balance Sheet the Forfeited Shares Account will appear as a separate item on the liability side until such time as the shares are re-issued. Forfeited shares may be re-issued at any price provided the new money added to the amount already received from the defaulting shareholder is not less than the total sum due on application, allotment, and calls on the shares in question. On re-issue the Bank Account is debited with the actual cash received and the Forfeited Shares Account is credited. The Forfeited Shares Account will then show a credit balance consisting of the cash received from both the defaulting shareholder and the new shareholder. An entry is made debiting the Forfeited Shares Account with the total of the amounts payable on application, allotment, and calls and crediting Share Capital Account. If, after making these entries, there remains a credit balance on the Forfeited Shares Account, such balance should be transferred by Journal entry to Reserve Fund or to General Reserve.

REDEEMABLE PREFERENCE SHARES

Section 46 of the Companies Act, 1929, permits, for the first time, a company to issue redeemable preference shares, subject to certain conditions, which are that such shares cannot be redeemed unless they are fully paid and then only out of the profits which would otherwise be available for dividend, or out of the proceeds of a new issue made for the purpose. When they are redeemed out of profits, a sum equal to the amount applied in redeeming the shares must be transferred to a Reserve Fund, designated "Capital Redemption Reserve Fund." Where redemption is by means of a fresh issue, if any premium is payable on redemption this must have been provided out of the profits before the shares are redeemed. Every Balance Sheet must specify what part of the issued capital consists of redeemable preference shares and the date on or before which those shares are, or are to be liable, to be redeemed.

DIVIDENDS

Except in those cases where bonus shares are allotted or a part or the whole of the profits are applied to the reduction of the unpaid capital, a company distributes so much of its profits as it

desires to disburse by means of dividends. Generally the Articles of Association give the directors power to declare interim dividends, but, for the final dividend, the directors recommend the amount that should be paid and the members sanction this at the annual general meeting by passing the resolution declaring the final dividend. Immediately this is done the dividend becomes a specialty debt, due from the company to the shareholders, and, as such, may be sued upon by the shareholders at any time within twenty years of the declaration.

It is customary to pay dividends in proportion to the amount paid up on the shares, but in the absence of any provision in the Articles of Association, a dividend is paid on the nominal value of the shares. Unless dividends are paid "free of tax" a company usually deducts income tax from the dividends. On the declaration of a dividend, a Journal entry is made debiting either the Profit and Loss Account or the Appropriation Account with the gross amount of the dividend, and crediting a "Dividend Due" Account, while the total income tax deducted from the dividend is debited to Dividend Due Account and credited to Income Tax Account. The details of the individual dividend warrants are entered on lists and, as the warrants are cleared, the lists are marked up accordingly and ultimately bound into a Dividend Book. When the payment is to be made, cash to the value of the total amount of the net dividends is transferred from the General Banking Account to a special Dividend Banking Account. As the dividend warrants are presented for payment they are liquidated from this special Dividend Banking Account and, periodically, the total of the dividend warrants negotiated are posted to the debit of Dividend Due Account. At the end of the year the balance at the credit of Dividend Due Account should agree with the balance outstanding in the Dividend Book and also with the remainder of the cash in the Dividend Banking Account, and will represent the dividends unclaimed. These unclaimed dividends will be shown on the Balance Sheet as a liability and the balance on the Dividend Banking Account will be shown as an asset and be included with "Cash at Bank." Unclaimed dividends arise where the shareholders have not presented their Dividend Warrants for payment.

There are several variations of this procedure; in certain cases,

only the net dividend, i.e. gross less tax, is debited to the Appropriation Account and credited to Dividend Due Account and no entry made for the income tax withheld by the company. In such cases the amount of income tax ultimately appearing in the Profit and Loss Account will be the total amount payable by the company and not the amount reduced by the tax recovered from the shareholders.

REGULATIONS GOVERNING ACCOUNTS AND BALANCE SHEETS OF LIMITED COMPANIES

The Companies Act, 1929, does not specify the form the Profit and Loss Account and Balance Sheet of a limited company should take, but there are certain sections of the Act which deal with accounting matters, the contravention of which imposes fines, and in some cases imprisonment on the delinquent persons. Below is given a concise summary of the major points of importance in these sections.

Section 110 calls for the Annual Return, which must be completed within twenty-eight days after the first or only general meeting in the year. A copy must be forwarded forthwith to the Registrar of Companies, to include a certified copy of the last Balance Sheet which has been audited by the company's auditors, including every document required by law to be annexed thereto, together with a copy of the auditor's report. This regulation regarding the Balance Sheet, etc., does not apply to a private company or to an Assurance Company which has deposited its accounts in accordance with the Assurance Companies Act, 1909.

Section 122 stipulates that proper books of account shall be kept at the registered office of the company or at such other place as the Directors think fit, and shall be open to inspection at all times by the Directors.

Section 123 requires a Profit and Loss Account and Balance Sheet made up to the same date, which date shall not be earlier than nine months prior to the meeting, or, in the case of companies with interests abroad, not earlier than twelve months preceding the date of the meeting, to be laid before the company in general meeting once at least in every calendar year. Attached to the Balance Sheet must be a report by the Directors on the state of the company's affairs, together with their recommendation regarding the payment of a dividend and the amount they propose to carry to reserve.

Section 124 specifies certain particulars which must be given in the Balance Sheet, viz. (a) the authorized and the issued capital, (b) sufficient details to disclose the general nature of the assets and of the liabilities and to enable one to distinguish between the "fixed" and "floating" assets, (c) a statement as to how the values of the fixed assets have been arrived at. This Section also enacts that, if not written off, any

preliminary expenses, any expenses incurred in connexion with an issue of shares or debentures, and, if it can be ascertained, the amount of goodwill, must be shown under separate headings. Finally it lays down that where any liability is secured on any assets otherwise than by operation of law, a statement to that effect must be made.

Section 125 deals with the method of showing subsidiary companies in a holding company's Balance Sheet, indicating that shares in subsidiary companies and amounts owing to and/or owing by subsidiary companies to the parent company must be shown separately.

Section 126 intimates that a statement must be annexed to the Balance Sheet of a holding company stating how the aggregate profits and losses of subsidiary companies have been dealt with so far as the holding company's accounts are concerned, and in particular how and to what extent provision for losses of subsidiary companies have been made, either in the accounts of the subsidiary companies or of the holding company. Further, how and to what extent losses of a subsidiary company have been taken into account in arriving at the profits and losses of the holding company. It also intimates that if the Auditor's report on a subsidiary company is in any way qualified, such qualification must be included in the aforesaid statement of the holding company.

Section 128 states that the amount of any loans made to Directors or Officers of the company during the period of the accounts, including any made and repaid during the period and any loans made prior to the period and still outstanding, shall be shown in the accounts, but this requirement does not apply where it is the company's ordinary business to make loans, nor to a loan to an employee which does not exceed £2000 and is certified by the Directors to be in accordance with the company's practice. This section also requires the total remuneration paid to Directors, both by the holding company and by the subsidiary companies, to be shown, although this latter provision is not applicable to a Managing Director and in the case of any other Director who holds a salaried office in the company only such sums paid by way of Directors' fees are to be included.

Section 129. In accordance with this section every Balance Sheet must be signed by two Directors, or if there is only one Director by that Director, and the Auditor's report must be attached to the Balance Sheet and the report must be read before the company in general meeting and be open to inspection by any member.

Section 131 enacts that an assurance company which does not deposit its accounts and Balance Sheet in accordance with the provisions of the Assurance Companies Act of 1909, and every company being a limited banking company, or a deposit, provident or benefit society, must publish, on the first Monday in February and the first Tuesday in August in every year, a statement giving the capital structure of the company and a summary of certain of the assets and liabilities in the form set out in the Seventh Schedule to the Act, and must exhibit such statement in a conspicuous place in the registered office and in every branch office of the company.

CHAPTER IV

INSURANCE AGENTS' ACCOUNTS

THERE are three sources from which an insurance company obtains its business: (1) agents, under which heading are included insurance brokers, (2) other insurance companies, and (3) direct from the insured.

AGENTS

There are two main classes of agents, the first being full credit agents and the second non-credit agents. The distinction between the two classes is that the former have authority to collect premiums and to give receipts, while the latter have no such authority. The credit agents are sometimes termed "full" or "account" agents, while the non-credit agents are often called "cash" agents. At certain regular intervals, either monthly or quarterly, the company renders a statement of account to the credit agent showing the agent's indebtedness to the company or vice versa, but no statement of account is rendered to a non-credit agent as such a procedure would be contradictory, although the company maintains an account in its ledger for every agent with whom it transacts business, both credit and non-credit. Agents are remunerated by commission and are reimbursed their actual out-of-pocket expenses incurred on behalf of the company.

OTHER INSURANCE COMPANIES

The business received from other insurance companies may be either by way of reinsurance or as a co-insurer on a scheduled risk. In the case of co-insurance, the practice is for each company to underwrite a definite percentage of the total sum insured on the risk and to issue a separate policy. The insured looks to each individual company for indemnification, whereas in the case of reinsurance, the insured is not interested in the reinsurance companies, but looks to the original company for satisfaction. Reinsurance business may be obtained through a treaty arrangement and/or by giving facultative cover to another office (see Chapter V).

DIRECT BUSINESS

Where an insured transacts his insurance business with a company without any intermediary, the business is known as "direct" and as such it does not carry any commission obligation, but in the event of the insuring company reinsuring any of this business it will receive from the reinsuring company, or companies, the appropriate commission.

Allowing for the variations in detail inevitable in concerns so numerous and of such magnitude, the salient features of the method of recording and accounting for the home business procured through home agents and direct are as outlined below.

RECORDING OF PREMIUMS AND COMMISSION—NEW BUSINESS REGISTER

In an ordinary commercial undertaking the sales and purchases are recorded in chronological order in a Day Book, so with an insurance company the new business is entered in chronological order in a New Business Register. This register may take the form of a book, either bound or loose-leaf, or the information may be punched on cards suitably coded, or duplicate policies or 'abstracts' thereof may be utilized. Whichever form is used, certain information should be readily available, viz. number of policy, date of policy, name of insured, subject and description of the insurance, sum insured, name of agent (with some method of identification, either by domicile or by code number), class of risk insured, the rate per cent, first premium, annual renewal premium, and renewal date. It is also advisable to have the amount of the commission payable to the agent both on the first and on the renewal premium. This latter requirement is essential where mechanical book-keeping is in operation.

RENEWAL REGISTER

The Renewal Register is compiled from the details appearing in the New Business Register, and is usually kept in agency order, that is, all policies through an agency falling due for renewal within a specified period, either monthly or quarterly, are grouped together. This register may take the form of a book, bound or loose-leaf, or the information may be coded and punched on cards, or the

information may be embossed on metal plates. Whatever form is used it should be capable of giving the following particulars: policy number, class of policy, renewal date, sum insured, renewal premium, name of insured, agent's name and identification mark, and commission payable.

For ready reference purposes a record should be kept of every policy in numerical order.

ENDORSEMENT AND CANCELMENT REGISTERS

The Endorsement Register may be compiled by extracting from the endorsements themselves, which are numbered consecutively the number of the policy affected, the name of the agent, the name of the insured, the alteration in the premium (if any), the corresponding alteration in the commission (if any), and the renewal date of the policy. This information is entered into a book ruled with four cash columns, the first or debit column for additional premiums, the second or credit column for return premiums, with the next two cash columns for the commission appertaining to the respective debit or credit premiums. Alternatively the form and the wording of the endorsement may be so arranged that the alteration in premium and commission is automatically extended into the respective cash columns. The endorsements are made out in duplicate, but on the original the two columns for commission are detachable by means of a perforation so that the commission is not shown when the original endorsement is attached to the policy. The duplicates, which are not perforated and which have two additional posting columns, are filed to produce the register. Where punched cards are in use, similar particulars as described above will be coded and punched on the cards.

No cancelment entry is made in the register until the renewal receipt or new policy is returned to the company.

Where the accounts and records are manuscript there are two additional columns in the register, in the first of which the underwriting department initial when the adjustments attributable to the endorsements and cancelments have been made in the Renewal and New Business Registers, and in the second column the book-keeping department initial when the entry has been posted in the agent's account. Where mechanization functions, the scheme

must provide for the verification of any alterations necessary on the plates or cards due to the endorsements and cancelments.

Separate New Business, Renewal, Endorsement and Cancellation Registers are kept for each class of business, and from these the total premium income and commission payable thereon, excluding reinsurance business, is obtained.

HOME AGENTS' ACCOUNTS

A separate account for each agent is maintained in a subsidiary Ledger which will be referred to as the Agents' Accounts or for brevity "A.A." Ledger, and which Ledger, on the score of economy and convenience, usually includes an account for direct business. The Ledger sheets will have separate columns for each class of business or all sections of business will be included in one column, dependent upon the system of book-keeping operated by the company, i.e. manuscript or mechanical. It must be recognized that the entries in the "A.A." Ledger do not constitute part of the double entry system.

POSTING OF PREMIUMS AND COMMISSION

From the several underwriting departments' New Business Registers, the individual premium amounts are posted to the debit of the agent's account concerned in the "A.A." Ledger, and the corresponding commission items to the credit of his account. In a like manner, each "Direct" premium is posted to the debit of a "Direct," or other appropriately named, account. In the General Ledger a total, or control, account is opened, which we will designate Agents' Control Account and into which the total of the premiums in the New Business Registers is posted on the debit side and the total of the commissions posted on the credit side. The double entry is completed in the General Ledger by crediting the premium totals to the various Premium Accounts and the commission totals to the debit of the various Commission Accounts.

As opposed to the debiting of new business item by item, only the total of each agent's renewal premiums is debited to his account in the "A.A." Ledger, and similarly the total renewal commission due to him is posted to his credit, also the total of the direct renewals is posted in the "Direct" account in the "A.A." Ledger. In the General Ledger the grand total of all renewal premiums and the

commission thereon is debited and credited respectively to the Agents' Control Account and the double entry effected by crediting the various Premium Accounts with the grand total of the renewal premiums and debiting the various Commission Accounts with the total renewal commission.

In each agent's account in the "A.A." Ledger implicated, the procedure as regards the posting of the debit endorsements—that is, additional and excess premiums—is similar to that of the new business, while each credit endorsement—that is, each return premium or rebate—and each cancelment is credited to the agent's account in the "A.A." Ledger. The commission on the former is credited and the commission on the latter debited to the agent's personal account in the "A.A." Ledger. The net balance of the endorsements, that is the excess of the debit endorsements over the credit endorsements and cancelments, is debited to the Agents' Control Account in the General Ledger and the net balance of the commission thereon credited. The double entry is achieved in the General Ledger by crediting the various Premium Accounts with the total net balance of the endorsements and cancelments and debiting the various Commission Accounts with the total balance of the commission. If it is the company's practice to post separately the total debit endorsements and the total credit endorsements and cancelments instead of posting the net result, the before-mentioned procedure, so far as the entries in the General Ledger are concerned, obviously will require modification.

When all these entries have been made, the total premiums due from agents and from direct connexions will have been recorded in the "A.A." Ledger and in the General Ledger will have been credited to the various Premium Accounts and debited to the Agents' Control Account, while the commission in respect thereof will have been taken care of.

LOSS AND CLAIM PAYMENTS NOT INCLUDED IN AGENTS' ACCOUNTS

Payments made under a fire policy are generally referred to as "losses" and those under policies of other classes of business as "claims," but until we come to consider the specific classes of business the one will connote the other.

It is not customary to allow home agents (agents in the United Kingdom) out of the moneys collected by them for premiums to make payments to the insured in settlement of losses and claims, and consequently particulars of losses and/or claims paid need not be recorded in the agent's account, the information being only of interest statistically.

AGENTS' POSTAGES, ETC.

The only items, therefore, remaining to be recorded in the agent's account are postages, and any other expenses incurred by the agent on behalf of the company, cash transactions, and any extraneous items such as annuity considerations and commission thereon. So far as postages and any other expenses are concerned, the agent usually deducts these when remitting the balance of his account, but before passing them as being in order they should be carefully scrutinized. They are credited to the agent's account in the "A.A." Ledger and in the General Ledger they are posted in total to the credit of the Agents' Control Account and to the debit of Agents' Expenses Account by means of a Journal entry.

CASH RECEIVED FROM AND PAID TO AGENTS

Frequently a separate subsidiary Cash Book is maintained for recording remittances to and from agents. The cash received from agents is entered on the debit side of the agents' Cash Book and from there posted to the credit of the individual agent's account in the "A.A." Ledger, while cash paid to agents is entered on the credit side of the agents' Cash Book and from there posted to the debit of the agents' account in the "A.A." Ledger. Any cash received in connexion with "direct" business is entered on the debit side of the agents' Cash Book and posted therefrom to the credit of Direct Account in the "A.A." Ledger. The daily totals of the agents' Cash Book are transferred to the main Cash Book and from there the total of the debit side of the agents' Cash Book is posted to the credit of Agents' Control Account in the General Ledger and the total of the credit side to the debit of Agents' Control Account. Statements of account are rendered to agents as soon as practicable after the days of grace have expired, so that the cash relating to the account in question is received from the agent in the subsequent period. To obviate such cash being posted to the

account for the next period, some companies maintain two Cash Books, one for the current accounting period and the other for the previous accounting period, the latter being kept open for a month or so after the accounts have been sent out. Thus for certain periods in the year there will be two agents' Cash Books in use, but when that for the previous accounting period is closed it is not brought into use again until the period following the current period. This system necessitates all cash being analysed and allocated to the applicable accounting period immediately it is received.

AGENTS' STATEMENTS OF ACCOUNT

The form of statement of account rendered to agents varies with different companies; some companies show on the statements only those items which are outstanding, while others render an exact replica of the agent's account in the "A.A." Ledger. Both methods have their advocates, but the introduction of mechanical book-keeping has brought the latter prominently to the fore, although the punched card system of mechanical accounting can be adapted to produce either form.

The practice of making all fire insurance policies, with the exception of short term or irregular period policies, renewable on one of the usual quarter days, irrespective of the date of the proposal, causes a very uneven distribution of the work of the Ledger clerk. Owing to the number of renewal receipts returned by agents for insurances which are not being renewed, it is not advisable to post the renewal premiums until the days of grace have expired, and as the accounts cannot be dispatched until the renewals are posted therein, the period immediately following the days of grace is, for the Ledger clerk, one of intensive work and, in the case of machine posting, constitutes the peak load period. Apart from ancient custom there does not seem to be any cogent reason why fire premiums should not fall due for renewal twelve months after the date of the proposal, as is the case in life, accident, motor, etc., business. Such an innovation would obviate the necessity of calculating the odd time in the case of each first premium and would enable companies to render accounts more promptly and at more frequent intervals. The fact that the plan has already been instituted by one or two companies proves its practicability.

BALANCING THE "AGENTS' ACCOUNTS" SUBSIDIARY LEDGER

Where the accounts are hand written, after all the postings are made, it is necessary to abstract the items appearing in each agent's account into an Abstract or Summary Book, taking a line for each agent. The book is a columnar one with the headings shown in the example on the next page.

When the columns in the Abstract or Summary Book are cast, the total of the Opening Balance column on the debit side less the total of the Opening Balance column on the credit side should agree with the Opening Balance of the Agents' Control Account in the General Ledger. Similarly, the total of any Premium column less the total of the corresponding Returned Premium column should agree with the balance of the Premium Account for that class of business in the General Ledger. In a like manner the totals of the remaining columns should tally with their respective control accounts in the General Ledger, while the difference between the totals of the Closing Balances on the debit and credit sides of the Abstract or Summary Book should equal the closing balance of the Agents' Control Account in the General Ledger.

Where the book-keeping is mechanical, this abstracting is eliminated as an accumulated total is recorded, either on a mechanical register forming part of the machine or on what is known as a proof sheet, each time a posting is made in an account. The proof sheet is an additional sheet which is inserted in the machine each time a posting is made affecting that particular account to which the proof sheet refers. To assist the machine operator, distinctive coloured sheets are utilized for each different proof sheet. Where punched cards are used they can be automatically listed and totalled by passing them through a machine.

The method of dealing with business emanating from foreign agents is as follows.

FOREIGN AGENTS' ACCOUNTS

Naturally the authority of foreign agents to commit the company is much greater than that of home agents, but even amongst foreign

[illegible][illegible]

Notes. The columns headed "Etc." under Premiums and Cancelled Commission on the debit side and under Returned Premiums and Commission on the credit side are to indicate that additional columns will be ruled sufficient to accommodate all classes of business for which the company maintains separate controls.

agents the extent of the authority delegated to them varies considerably. Even so, practically all are empowered to draw bills of exchange upon the company. There are exceptional cases where the foreign agents are even permitted to underwrite risks and to settle losses. At regular intervals, either monthly or quarterly, foreign agents render accounts to the company, including therein the premiums written (which will comprise new business and renewals), the commission thereon, losses and expenses paid, and showing the balance due to the company. Only on very rare occasions is the balance on a foreign agent's account against the company, because losses of any substantial amounts are met by bills of exchange drawn upon the company. Where there are no outstanding premiums or where the agent is a "del credere" one—that is one who, for an additional consideration, undertakes to hold himself responsible for any bad debts—a remittance for the amount of the balance, as shown by the account, accompanies the account. In other cases, the agents remit the cash they have in hand, accompanied by a statement enumerating the outstanding premiums, thus reconciling the amount of the draft with the balance as shown on the account. As a general rule it is not practicable to have all foreign agents' accounts audited at the domicile of the agency and consequently vouchers for all payments made by the agents on behalf of the company are forwarded with the accounts.

At fixed regular intervals foreign agents forward to the Head Office lists of new business, renewals, endorsements, cancelments and losses. These lists are checked by the underwriting departments and when certified as correct utilized by the accounts' department to verify the figures appearing in the foreign agents' statements of account.

The accounts rendered by the foreign agents are, of course, compiled in the currency of the country in which the agency is domiciled and the question of converting that currency into English sterling, for incorporating the figures in the Revenue, Profit and Loss Accounts and Balance Sheet of the company, is one that has given rise to much discussion during the last few years because of the violent fluctuations in the rates of exchange.

RULES FOR CONVERTING FOREIGN CURRENCY FOR ACCOUNTANCY PURPOSES

The following are the rules recognized by the accountancy profession for converting foreign currency items in accounts into English sterling—

(1) Fixed assets are taken at the actual cost, that is, the rate of exchange ruling at the date of the purchase is used for conversion, but it is desirable to provide for any diminution in value due to a permanent fall in the rate of exchange.

(2) Floating assets and liabilities are converted at the rate of exchange ruling on the date to which the accounts and Balance Sheet are made up.

(3) Revenue items are converted at the average rate for the period, or in some cases, at the normal rate.

(4) Remittances are not converted at any fixed rate of exchange, but the actual sterling received or paid is used.

Where foreign agents render monthly accounts accompanied by a remittance for the balance, the rate at which the remittance is converted into sterling is generally applied to the conversion of the remaining items in the account. In other cases, when all the items in the account have been converted in accordance with the foregoing rules, it will be found that the total of the items on the debit side is not in agreement with the total of the items on the credit side. The difference, which is inserted to bring the converted account into balance, is a profit or a loss in exchange and is ultimately carried to Exchange Account in the General Ledger.

Where there are a considerable number of foreign agencies transacting business, the individual accounts of such agents are maintained in a subsidiary Ledger and a control account operated in the General Ledger which may be designated Foreign Agents' Control Account. The method of dealing in the Head Office books with the entries appearing in the accounts of foreign agents is identical with that outlined for home agents' accounts, except that bills of exchange and "exchange" items are very rarely met with in home agents' accounts. Any bills of exchange transactions are recorded in the manner outlined in Chapter I. With the exception of losses in foreign agents' accounts, which will be referred to below, all the items incorporated in both home and foreign agents' accounts have now been reviewed, but the following additional matters need expounding.

LOSSES AND CLAIMS (HOME)

On receipt of an advice of a loss the details on the advice are checked by the loss clerk to verify that the policy is in force and that the remaining information is in order. Then the particulars are entered in a Loss Book, or Register, which is ruled to provide for a loss number, the date of the loss, the number of the policy, the insured, the subject of insurance, the agent, an estimate of the amount of the loss, the amount paid, the date of payment and the date the discharge in settlement is received. Some companies also have provided in the book a column for reinsurance recovered in connexion with losses. A separate Loss Book is devoted to each class of business. Separate columns in the Cash Book are utilized for all the various classes of loss payments, or a separate Loss Cash book is used, with columns for the different sections of business. Periodically the totals of the payments are posted to the debit of the respective Loss Accounts in the General Ledger and agreed with the totals of the payments columns in the Loss Books. The double entry will have materialized by the Cash or Bank Account having been credited with the payment.

LOSSES AND CLAIMS (FOREIGN)

The totals of the losses of the various classes of business through the foreign agents' accounts are debited from the Abstract Book to the various Loss Accounts in the General Ledger and credited to Foreign Agents' Control Account through the medium of a Journal entry. It is the custom for foreign agents to send advice of losses immediately they occur so that they will have been recorded already in the various Loss Books.

RESERVE FOR OUTSTANDING LOSSES AND CLAIMS

At the end of each financial period, certain losses will have been intimated but will not have been settled, and to arrive at the true underwriting results for the period it is necessary to make provision for such cases. This is accomplished by debiting the current year's Loss Account with the total losses outstanding and crediting an account called "Outstanding Losses," although in practice, instead of crediting an Outstanding Losses Account, the item is simply brought down as a credit to Loss Account in the following year

and shown as a liability in the Balance Sheet in the same way as the Outstanding Losses Account would be shown as a liability.

MANAGEMENT EXPENSES

The responsibility for authorizing payment of all expenses should be that of some senior official duly appointed for the purpose, and a detailed analysis of expenses, comparing the expenditure under certain predetermined headings with the corresponding items for the previous year, should be examined by the management at regular intervals. The payments are credited in the Cash Book and from there posted to the debit of an Expenses Account in the General Ledger. With the object of analysing the expenses it is customary to keep a subsidiary book, divided into sections, one section for each of the various headings of expenses.

RESERVE FOR OUTSTANDING AND ACCRUED EXPENSES

At the time the books are being closed, certain expenses will have accrued but will not have been paid, so provision for such expenses should be made in order that each financial period may bear the true proportion of expenses appertaining thereto. This is accomplished by debiting the Expenses Account and crediting either a Reserve Account or, conforming to present-day practice, bringing the item down as a credit to the following year's Expenses Account. With either course the reserve is included in the Balance Sheet as a liability.

As regards any expenses paid in advance, the period which they cover not having elapsed at the time the books are closed, it is not an uncommon experience to find that an insurance company has not taken credit for the unexpired portion of such expenses. While such a course penalizes the revenue account for the initial year, subsequent years' revenue accounts will not be affected provided the expenses under consideration are of a recurring nature and are standardized as to amount, and whereas each year's accounts and Balance Sheet, taken individually, will reflect a less favourable position than is actually the case, comparing one year's accounts and Balance Sheet with another their undisclosed strength will be identical. In the case of those companies who make the adjusting entries, the procedure is to credit the Expenses Account and to

debit an account "Amounts paid in advance," or, again following the modern trend, bring the item down as a debit to the Expenses Account in the following year, showing the amount as an asset in the Balance Sheet.

APPORTIONMENT OF EXPENSES

Composite companies have certain expenses such as advertising, light and heat, rent and rates, remuneration of administrative staff, etc., which it is impossible to allocate definitely to any specific department, although they have been incurred for the benefit of all the departments; hence it is necessary to devise some method of apportioning them. Rent and rates may be chargeable to the various sections of business on the basis of the space occupied, but the other items of expense cannot be so equitably divided. Some companies apportion expenses of this description *pro rata* to the premium income, but such a scheme will not bear very close investigation; others apply this formula to certain of such expenses and divide the remaining expenses on the basis of the number of policies in force in each section of business. Whatever method is evolved for segregating departmentally the indefinite expenses it can only be considered an arbitrary one, and it therefore behoves the company to work to some plan which is not so elaborate as to become uneconomical.

CHAPTER V

REINSURANCE ACCOUNTS

WHEN an insurance company "gives off" to other insurance companies part of the risks or liabilities it has undertaken, it is said to reinsure those risks. The company giving off the business, commonly referred to as the ceding company, pays the reinsuring company a premium, in return for which, in the event of a loss arising, the reinsuring company reimburses the ceding company an agreed proportion of the loss, according to the terms of the contract. Reinsurance is often known as guaranteeing, the reinsuring company guaranteeing to reimburse the ceding company when the contingency insured against crystallizes. The contract of reinsurance is between the ceding company and the reinsuring company (known as the guaranteeing office) to which the insured is no party, so that should the reinsuring company fail to meet its obligations, such a contretemps would not affect the insured's right against his insurers. Conversely, the insured cannot claim direct from the reinsuring company in the event of his insurers failing. Reinsurances are arranged on the same terms, conditions, and rates as the original insurance, but the rate of commission payable by the reinsuring company to the ceding company is much higher than that paid by the ceding company to its agents. This discrimination is quite justifiable on the grounds of equity, because the ceding company has to stand the cost of obtaining and supervising the business, which is substantial, and, as the reinsuring company benefits therefrom it should contribute towards the cost thereof.

Reinsurance may be divided broadly into two groups, Facultative and Treaty.

FACULTATIVE REINSURANCE

Here particulars of each risk to be reinsured or guaranteed are submitted to the reinsuring companies in the form of a Request Note. The reinsuring companies may either accept or decline the business; if they accept the risk they issue a Take Note which is stamped and this constitutes their agreement in writing of the offer submitted by the ceding company. Thereafter the ceding

company issues to the reinsuring company a specification giving details of the insurance and quoting the Take Note number for reference. Temporary protection, pending the issue of a Request Note, is sometimes obtained by the reinsuring companies initialing on a Reinsurance Slip against the amount they are prepared to take. As a general rule, reinsuring companies do not accept amounts in excess of that retained by the ceding company. For convenient reference each facultative reinsurance is given a separate guarantee number.

TREATY REINSURANCE

Here an agreement is entered into by the ceding company and the reinsuring companies whereby the latter undertake to accept without the option of declining any amounts offered within the terms of the treaty. No Request Notes or Take Notes are issued but Bordereaux, which are statements giving the salient details of the risks concerned, are sent periodically by the ceding company to the reinsuring companies, although in practice the majority of treaties nowadays do not provide even for this information to be given to the reinsuring companies. A clause is usually inserted in the treaty entitling the reinsuring companies to inspect the ceding company's treaty cession books. The advantage of a treaty reinsurance arrangement is that it enables an insurance company to give immediate cover for sums greatly in excess of its own retention limits without having to canvass reinsurance companies, as the treaty empowers it to place any surplus, up to the capacity of the treaty, simultaneously with its own acceptance.

ACCOUNTING FOR REINSURANCE BUSINESS

PREMIUMS

Immediately a new order for insurance is received and the rate agreed, the underwriting department determines what proportion of the total insurance the company will retain. The details are then entered on a form or punched on a card and the form or card passed to the Guarantee Department to obtain the necessary reinsurance cover for the surplus insurance. In the event of the treaty participation not being sufficient to absorb the whole of this surplus, the balance is reinsured facultatively. This further information is also entered on the form together with the renewal date,

and where punched cards are used, the requisite punching done. A note of the amount reinsured is made against the policy in the Policy Register.

In the Guarantee Accounts Ledger, which contains the personal accounts and which is a subsidiary Ledger, there is a separate account for each facultative office, but only one account for treaty companies. The essential analysis for the individual offices on the treaty is generally contained in a further subsidiary Ledger. Facultative reinsurance premiums on new business are posted item by item to the credit of the guaranteeing companies' personal accounts, but in the case of the new business for the treaty companies the forms or cards are totalled and the total only posted to the credit of Treaty Companies Account in the "G.A." Ledger. The entries in the General Ledger are to debit Reinsurance Premiums Account with the total of the reinsurance premiums on new business, both facultative and treaty, and to credit Reinsurance Companies Account, although some companies make the debit entry direct to Premium Account. After the quarter's new business has been balanced, the forms, or cards, are sorted and marshalled in order of renewal dates, thus forming the Reinsurance Renewal Register. At the end of each quarter every form renewable in that quarter is checked against the Policy Register to verify that the policy is still in force and that no alterations in the premium have taken place. The total of the treaty renewals are thereafter posted to the credit of the Treaty Companies Account in the "G.A." Ledger. So far as facultative renewals are concerned, it is the practice of guaranteeing offices to submit to the ceding company a list of renewals falling due in the quarter, which list the ceding company marks up, revising the total where necessary, and returns to the guaranteeing offices. The totals of each facultative office's renewals are credited to the respective office's account in the "G.A." Ledger. In the General Ledger, either the Premium Account or Reinsurance Premiums Account is debited and Reinsurance Companies Account credited with the total renewals, both facultative and treaty. Cancellments and endorsements are entered in books or loose sheets designed for the purpose or separate cards are made out and the items posted in a similar manner with, of course, the obvious alterations as regards the debiting and crediting of the accounts.

COMMISSION

The rate per cent of commission payable to the ceding company by companies giving facultative cover is less than that payable by companies on the treaty, commensurate with the additional work undertaken by the facultative companies. As the commission payable by treaty companies is uniform, there is no advantage in making a separate calculation for commission applicable to each premium; the total commission can be computed in one amount on the total premiums "given off." The commission payable on facultative business varies with different companies and sometimes even with different insurances with the same companies, and as individual postings are made for facultative reinsurance, individual calculations of commission can be computed if necessary. In the "G.A." Ledger the total treaty commission is debited to the Treaty Companies Account and the commission on the facultative business debited to the individual guaranteeing companies accounts, while in the General Ledger the total commission is credited either to Reinsurance Commission Account or to Commission Account and debited to Reinsurance Companies Account.

LOSSES AND CLAIMS

On receipt of an advice of a loss, the loss clerk examines the Policy Register to ascertain whether any part of the risk has been reinsured, and, if so, the loss papers are passed to the Guarantee Department in order that they may claim from the reinsurers the amount to be recovered. Losses in excess of a predetermined amount are claimed immediately, while those losses below the agreed minimum figure are debited in account. The entries in the General Ledger are a debit to Reinsurance Companies Account and a credit either to Loss Account or to Reinsurance Loss Account.

TREATY COMPANIES DEPOSIT OR RESERVE

Treaties usually provide for the ceding company to retain against each treaty company 40 per cent of the premiums ceded for the past twelve months, allowing the treaty companies interest on such amounts at a pre-arranged rate. Some of the treaty companies deposit with the ceding company securities of a market value

approximately equivalent to the required 40 per cent reserve, so that the full premiums less commission and losses may be paid to them without any adjustment on account of the 40 per cent. In such cases the interest or dividends from the securities so deposited are paid direct to such treaty companies. Where no deposit is made the amount of the 40 per cent reserve applicable to each company is entered in the relevant account in the Ledger provided for the treaty companies, and any increase or decrease in the amount adjusted at the end of the quarter. The total of these reserves is debited in the "G.A." Ledger to Treaty Companies Account and in the General Ledger the Reinsurance Companies Account is debited and Reinsurance Reserve Account credited. Where 40 per cent of the premiums is retained and interest allowed thereon, the total gross interest for all the treaty companies is debited to Interest Account in the General Ledger and credited to Reinsurance Companies Account, while the appropriate income tax thereon is credited to Income Tax deducted from Interest Account and debited to Reinsurance Companies Account.

PROFIT COMMISSION

Some treaties incorporate a provision entitling the ceding company to profit commission on the profits realized by each of the reinsuring companies from its share of the treaty. The individual company in the treaty companies' Ledger is debited with its proportion of the profit commission and the total profit commission is debited to Treaty Companies Account in the "G.A." Ledger. In the General Ledger Reinsurance Companies Account is debited and Commission Account or Reinsurance Commission Account credited.

CASH

Cash received or paid by the ceding company in connexion with facultative business is posted to the account of each company separately, but any cash transactions appertaining to treaty companies is posted in total to the Treaty Companies Account in the "G.A." Ledger and also to the account of the individual company in the treaty companies' separate Ledger. In the General Ledger the aggregate cash is posted to the Reinsurance Companies Account periodically.

STATEMENTS OF ACCOUNT

Statements of account for the facultative offices are prepared each quarter from the "G.A." Ledger. The items included in the Treaty Companies Account in the "G.A." Ledger are apportioned to each company participating in the treaty according to the proportion each has undertaken to reinsure. These apportionments are then entered in the personal accounts of the companies comprising the treaty and statements of account rendered to them.

CHANGE OF COMPANIES ON THE TREATY

There is a clause in every treaty reciting the mode to be adopted for adjusting a reinsuring company's liability when it "goes off" the treaty. The cancelling of a reinsurer's liability is either by way of "portfolio" or "running off." In the former case, the reinsuring company pays the ceding company a certain percentage of the premiums, usually 40 per cent, in consideration of it being relieved of all liability for future losses. This is colloquially known as "sudden death" cancellation. In the latter case, the account of the reinsuring company remains open in the books of the ceding company until all losses in respect of any premiums credited to that account have been settled and any returns affecting those premiums have been debited. The ceding company retains so much of the deposit or reserve as is sufficient to cover an estimate of the ultimate liability until such a time as all the losses are disposed of.

FOREIGN BUSINESS CEDED TO FACULTATIVE AND TREATY COMPANIES

Foreign business which is reinsured is treated in a similar manner, except that, as regards any treaty reinsurance arrangements, the treaty generally stipulates that the reinsurance premiums shall be calculated at the same rate of exchange as that which the ceding company uses for converting the original premiums, and, as regards losses, the same rate of exchange shall be employed as the ceding company adopts for paying the losses. Frequently there is also a condition in the treaty that all balances due to or from the reinsuring companies on the treaty shall be settled in sterling.

The accounting records enunciated above relate to business "given off" and it now remains to study those in connexion with

insurances received from ceding companies both treaty and facultative.

INWARD TREATY BUSINESS

As previously stated, the modern practice is to dispense with bordereaux, accordingly the reinsuring company receives no intimation of the premiums it is entitled to or the losses it is liable for—with the exception of those losses in excess of the predetermined amount, which are advised specially—until such a time as it is furnished with a statement of account. An account is maintained for each treaty in which the company is interested and should there be many in number it may be expedient to resort to a separate subsidiary Ledger in which to keep the accounts, otherwise, they may be included in the "G.A." Ledger.

On receipt of the statement of account the details are transcribed therefrom into the account for that treaty and any cash transactions relating thereto posted from the Cash Book.

Periodically the premiums, losses, commission, etc., in all these treaty accounts are totalled and respectively posted to the credit of the various Premium Accounts and to the debit of the various Loss, Commission, etc., Accounts in the General Ledger.

Assuming the company belongs to the category which deposits securities with the ceding company, it will not be necessary to formulate any book-keeping entry to signify such a deposit has been made, but the fact should be noted at the head of the account of the investment hypothecated. Conversely, where the company agrees to the ceding company charging the reserve of 40 per cent in account, it has the option of either refraining from making any entry or crediting the ceding company's account with the amount withheld and creating an asset for a similar sum to complete the double-entry. By exercising the former option the balance of the ceding company's account in the company's books will stand at a figure which differs to the extent of the 40 per cent reserve from the balance shown on the statement of account rendered by the ceding company, whereas by adopting the alternative procedure this discrepancy is avoided. Any interest received appertaining to such cash deposit is credited to Interest Account.

Treaties generally do not provide for the reinsuring companies

being charged with outstanding losses, so some of the more prudent companies, which have lines on several treaties, set up a reserve of their own for such eventualities.

INWARD FACULTATIVE BUSINESS

In a subsidiary Ledger a separate account is opened for each company from which facultative business is obtained, and on receipt of the statement of account from the ceding company it is checked against the account. At certain defined times these facultative accounts are aggregated in a summary book and the total premiums are credited to the various Premium Accounts and the total losses and commission debited to the various Loss and Commission Accounts in the General Ledger.

CHAPTER VI

INSURANCE COMPANIES' BRANCH OFFICES ACCOUNTS

THE majority of insurance companies, in addition to being represented by agents at home and abroad, have branches established at home and abroad, and a disquisition on the method of recording in the Head Office books the transactions of such branches is now due.

There is a diversity of practice amongst branches; some merely obtain the insurance proposals and leave all the underwriting to be done at the Head Office, whilst others do their own underwriting, including the issuing and obtaining of guarantees, and only receive instructions from the Head Office as to the company's limits of retention. These two types define the extremes within which all other branches are conducted. Similarly with the book-keeping, certain branches maintain a complete set of account books, and have a Bank Account on which they can operate; others merely keep a Cash Book, as the extent of their accounting requirements is the recording of the collection of the balances due from agents as shown on the accounts sent out from Head Office, the collections being paid into a local Bank for the credit of Head Office. Subject to the institution of some method of controlling and supervising them, this latter form of branch needs no further consideration.

HOME BRANCHES

BRANCH ACCOUNT TO HEAD OFFICE

It is usual for those branches which have a complete set of account books to render to the Head Office a periodical account—either monthly or quarterly—giving a summary of the whole of the branch financial transactions. This account includes, *inter alia*, on the income side the opening balance, premiums written under the various classes of business, annuity considerations, bank interest and any other interest, rents from buildings owned, assignment fees, fines, income tax deducted from annuity payments, remittances from Head Office, amounts received on behalf of other branches

and/or Head Office, etc., and on the outgo side commission on the various classes of premiums, expenses of management, losses, claims, surrenders, bonuses paid, rent disbursements, property tax, remittances to Head Office, amounts paid on behalf of other branches and/or Head Office, etc., and the closing balance. The closing balance is the amount due to Head Office, and on a supplementary statement an analysis of this amount is given, which analysis shows cash in hand, cash at bank, agents' balances, outstanding premiums and any other assets, also outstanding losses, expenses, and any other liabilities.

POSTING OF BRANCH BUSINESS

Where the branches are numerous, the Head Office has a subsidiary Ledger containing an account for each branch and a total account in the General Ledger designated "Branch Control." The specific Branch Account in the subsidiary Ledger is debited with the sum total of the various items on the income side of the account rendered by the branch, excluding, of course, the opening balance, which is the amount brought forward from the previous period. In a like manner the total of the items on the outgo side of the account rendered by the branch, excluding the closing balance, is credited to the account of the branch in the subsidiary Ledger. In the General Ledger, instead of making separate Journal entries for each branch, crediting the various Premium Accounts, etc., and debiting the various Commission Accounts and Expenses Accounts, the items of the same nature for all branches are summarized and the grand totals posted to the credit of the various Premium Accounts, etc., and to the debit of the various Commission Accounts, etc. The aggregate total of the summarized debits is debited to the Branch Control Account and the aggregate total of the credits credited to that account.

CASH BOOK FOR BRANCH TRANSACTIONS WITH HEAD OFFICE

Where the branches are numerous and remittances between them and Head Office frequent, it is an advantage for Head Office to have a subsidiary Cash Book devoted entirely to the branches. From this subsidiary Cash Book any cash affecting a branch is posted to the

relevant branch account in the subsidiary Ledger, while the debit and credit totals of this Cash Book are periodically incorporated in the main Cash Book and from there posted to the Branch Control Account in the General Ledger.

BALANCE OF BRANCH ACCOUNTS

The balance of the Branch Control Account in the General Ledger should agree with the total balances of the branches in the subsidiary Ledger. In the account books of the branches the transactions are recorded as outlined in Chapters IV and V, and the revenue accounts are closed by transferring the balances thereof to a Head Office Account in their Ledgers.

BRANCH BANKING ARRANGEMENTS

As a precautionary measure all cash received, of whatever nature, should be paid into the bank daily, and only certain Head Office officials authorized to draw on this Bank Account. It is not an unusual occurrence for an arrangement to be in force whereby the branch bank automatically transfers to Head Office any balance in excess of a pre-arranged limit. As regards payments made by the branches, a Bank Account is opened which is replenished by cheques from Head Office and on this account branch officials are authorized to draw up to a specified limit. For petty cash payments the branch manager draws a cheque on this account and hands the cash to the petty cashier. Arrangements should be made with the branch's bank to forward direct to Head Office a certificate of the bank balance or balances as at the date to which the account from the branch is made up.

CENTRALIZATION *v.* DECENTRALIZATION

While considering the subject of home branches it is opportune to examine the advantages of centralization as applied to agents' accounts compared with decentralization.

Viewed from an economical aspect, where the accounts are mechanized, the advantages of centralization are apparent as the total machines required to equip each branch adequately is greatly in excess of the number required if the accounts are centralized and, in addition, under the former conditions at some branches the

machines would not be working to their full capacity. Where centralization is functioning, the detection of any defalcation and of the manipulating of agents' accounts is more speedily discovered and, to a considerable extent, the opportunity minimized, due to the necessity, in such cases, of collusion between a branch official and a Head Office official. The dispatching of both the accounts and reminders for outstanding balances direct from Head Office to the agents is a further preventive measure. Centralization establishes an immediate check at Head Office on each item of branch expense, whether agency or management, whereas under decentralization such a check is only operative either on receipt of the periodical accounts from the branch, and then probably only in total, or on receipt of the auditor's report. A natural corollary to centralization is the certainty of uniformity of practice throughout the company's branches.

The arguments against centralization are—

1. The increased correspondence with the branches and the additional postage charges due to the branches each day forwarding documents and letters affecting the accounts.

2. The inability of the branch officials to give an immediate explanation to an agent of any item on the statement of account which the agent may query.

3. Possibly the only opportunity a branch official has of approaching certain agents for new business is the occasion on which the agent's account is rendered to him or when application is made to him for his outstanding balance, and unless the accounts are issued by the branches and the balances collected by them, this personal "touch" may be lost.

4. The idiosyncrasies of the different agents can neither be recognized nor catered for.

5. There is usually a hiatus of at least a day between a branch receiving a remittance, a returned renewal receipt or new policy and the recording thereof in the Ledger at Head Office, with the result that should the agent's account be dispatched on the prior day such items probably would be omitted from the account, although any complaint by an agent on this score can be met partially by stamping on the statement of account the date up to which the account has been compiled.

FOREIGN BRANCHES

The majority of countries outside the United Kingdom insist on insurance companies depositing substantial amounts of such country's own government securities, or other selected securities, as a precedent to transacting business. These deposits are looked upon primarily as a protection for those countries' nationals who have insured with the companies, but the increasingly stringent demands made by countries abroad upon the foreign companies operating in their territory is a tacit admission of the desire to foster the advancement of native companies against the competitive merits of foreign companies. Notwithstanding this discrimination, British companies continue to offer their protection world-wide, and as a sequence to complying with these demands, foreign branches of British companies often have on their books the investments which have been so deposited and, naturally, their accounts incorporate the interest and/or dividend entries appertaining thereto. This feature, together with that of the exchange and foreign taxation, are the chief distinctions between the accounts of a home and of a foreign branch.

Owing to the element of distance and the time occupied in corresponding, foreign branch managers are given a power of attorney authorizing them to act for and on behalf of the company in all matters affecting the company's business in the territory under their control.

BANKING ARRANGEMENTS FOR FOREIGN BRANCHES

In those places abroad where a local Board of Directors has jurisdiction, it is not an uncommon procedure to arrange for cheques on the principal banking account, into which all moneys received are paid, to be signed by any one of such directors in conjunction with one of certain specified senior officials. Cheques drawn on the "working" bank account, which account is replenished by cheques drawn on the principal banking account and kept within a limited scope, are signed by officials only. Where there is no local Board of Directors, the auditors at the branch sometimes act in this capacity for the signing of cheques, while in other cases, where such precautionary measures cannot be instituted, the arrangements are for cheques up to a certain sum to be signed by one official and

cheques for amounts exceeding that sum to be signed by two or more officials.

HEAD OFFICE ADMINISTRATIVE EXPENSES DEBITED TO FOREIGN BRANCHES

In a large number of foreign countries the authorities, when assessing the profits of the branch for local taxation purposes, allow the cost of Head Office supervision as an expense of running the business. Some companies take advantage of this concession to debit their foreign branches with a fixed percentage on the branch's premium income to cover this supervision charge. While this basis cannot be considered scientific, it must be admitted that to obtain a definite figure to represent this charge accurately is impossible, e.g. to allocate the proportion of the time of the Head Office management, accountants, and secretarial departments devoted to each foreign branch would be a colossal, if not an impossible, task.

Some companies find it expedient to install a subsidiary Ledger containing an account for each foreign branch and a total, or control, account in the General Ledger called "Foreign Branches Control." The *modus operandi* for recording the transactions of such branches is similar to that described for home branches, but, of course, there is the additional problem of exchange, which is dealt with in a similar manner to that outlined for foreign agents.

CHAPTER VII

INSURANCE COMPANIES' INVESTMENTS

AN ordinary commercial undertaking has to purchase its goods and/or raw material before it is in a position to sell its merchandise, but with an insurance company it sells its insurance and receives the premium long before it has to meet any claims, or at least, this is so in the large majority of cases, and is especially so in the life department; consequently a composite insurance company almost invariably has money available for investment.

Consideration of the class of investment insurance companies make and the advantages and disadvantages of each is outside the scope of this book, but the books it is necessary to keep to record the investment transactions and the actual recording are matters which fall within its ambit.

The major portion of insurance companies' investments consists of stock exchange securities, that is investments which are dealt in on one or more of the stock exchanges of the world, and as a result thereof, speaking generally, can be bought or sold immediately.

THE PURCHASE OF AN INVESTMENT

It is the particular province of the Directors to decide the investment policy of the company and when they authorize the purchase of an investment, the instructions are passed on to the stockbroker, who, after completing his bargain on the Exchange, forwards a Bought Contract Note to the company. This Contract Note shows the name of the investment, the par value of the stock or the number of shares purchased as the case may be, the price, the total amount of cash due from the company—which amount will include the broker's commission and the cost of the contract stamp—and the date settlement has to be made. The Contract Notes are filed for permanent reference.

A separate account for each security purchased is maintained in a subsidiary Ledger, called the Stock Exchange Investments (S.E.I.) Ledger, which is ruled with debit and credit columns for

Capital and Revenue. The Assurance Companies Act, 1909, lays down the various headings under which stock exchange investments must be shown in an insurance company's Balance Sheet, and it is advisable to have the Ledger sectionalized to correspond with these headings, and, where a company also operates in the Irish Free State, to provide further sections for I.F.S. investments, so that the company may readily conform to the requirements of the Assurance Companies Act, 1909, as adapted by the I.F.S. Adaptation of Enactments Act, 1922, Adaptation Order, 1928, and the I.F.S. Insurance Act, 1936.

The following information regarding each security may be recorded either on cards or in a loose-leaf book, or the folio facing the account in the "S.E.I." Ledger may be ruled to accommodate it, but this latter course has a disadvantage which will be explained later—

- (1) The full name and description of the stock or shares.
- (2) The country of origin of the investment.
- (3) The par value of the stock or the number of the shares.

N.B. In the case of shares the distinctive numbers should be given.

- (4) The date of the purchase.
- (5) The purchase price.

N.B. This should be the capital price only, and should ignore any accrued interest to date of purchase, which, in England, is included in the quotation. In the case of Life investments the brokers' charges and the cost of stamps are shown separately.

(6) The accrued interest purchased, and the interest earned by the investment from the date of purchase to the next interest due date; also the income tax thereon in each case.

(7) The redemption date, if any, and the redemption price.

(8) The annual, half-yearly or quarterly dates on which the interest falls due for payment.

(9) If the investment is one having a fixed rate of interest, the amount of that interest for each interest due date and the income tax thereon.

(10) If the investment is a fixed interest bearing security, the amount of interest accrued due from the last interest due date to the 31st December, or to whatever date the company's year ends, with the income tax thereon.

(11) Whether the investment is in registered, inscribed or bearer form.

N.B. The tangible evidence of ownership of registered securities is a stock or share certificate which is of no monetary value in itself. Registered securities are transferable by deed.

The tangible evidence of ownership of inscribed securities is a stock receipt, which is also of no value in itself. The transferring of inscribed securities is accomplished by the owner inscribing his name, either personally or by some person authorized by him under a power of attorney, in the stock books of the bank acting as custodian of the stock.

The tangible evidence of ownership of bearer securities is the possession of the bonds themselves, which naturally are valuable. A transfer of bearer securities is made by mere delivery.

(12) If the investment takes the form of bearer securities, whether coupons to redemption date are attached or, if coupons to a prior date only are attached, whether a talon is attached for further coupons.

(13) If the investment is in bonds, the distinctive numbers of the bonds.

(14) The annual amount of sinking fund which is to be applied to the investment.

N.B. If the securities are purchased at a price in excess of the redemption price, an amount is set aside out of the annual interest and applied to the reduction of the capital value so as to bring the capital value of the security down to the redemption value by the redemption date.

(15) How the interest is paid, whether direct to the company's bank or how otherwise.

(16) The sale price, giving separately the capital value and accrued interest sold, also the income tax thereon, and, in the case of life investments, showing the broker's charges and expenses separately.

Owing to the changes in the standard rate of income tax, often the income tax items are omitted from these records, thus avoiding continual alterations in the data.

There are several variations of this scheme, e.g. sometimes different coloured cards, or leaves, are used to indicate different countries; thus all British securities may be on white cards and all French securities on yellow cards and so on for each country's securities. This, of course, would dispense with the necessity for item (2).

Interest on the majority of investments is payable half-yearly, and the cards or loose-leaf book containing the foregoing information should be arranged in order of interest due dates, the first section being for securities with interest falling due in January and July, the second for those with interest falling due in February and August, and so on. Where interest is paid quarterly, a duplicate is made out, but item (10) "Accrued interest to the end of the year" is omitted therefrom, and the duplicate is filed in its proper place in

the relevant months. The reason for omitting item (10) from the duplicate, if this method is used, is that at the end of the accounting period the amounts included in (10) are totalled, and if this was filled in on the duplicate it would entail unnecessary precaution to prevent the amount being included twice. Alternatively, a different coloured card can be used unless this method of differentiation is already in use for some other purpose, as described above. In cases where interest is paid once a year only, the fact is noted prominently on the face of the card or leaf.

For quick reference a visible card index file showing the investments in alphabetical order is maintained, so that at a glance the total amount of the company's holding in any one security can be seen, and, where a number of different securities are all under the control of one group or system, a card for the group is made out so that the company's holding, both in the individual securities of the group and in the group as a whole, can be readily ascertained.

Owing to the numerous cash entries appertaining to investments a separate subsidiary Cash Book is desirable, which is ruled with two sets of columns, one for Capital and one for Revenue.

On settlement day a cheque in payment of the amount shown on the Bought Contract Note is sent to the broker and an entry made in the subsidiary Cash Book as a credit to the bank. At a subsequent date this entry is posted to the debit of the investment concerned in the "S.E.I." Ledger. The cash payment is divided between Capital and Revenue, the Revenue portion consisting of the gross accrued interest to the date of purchase and the income tax thereon, while the broker's commission and the cost of the contract stamp are treated as part of the Capital expenditure, but in the case of life investments the broker's charges and expenses are treated as expenses for taxation purposes (page 100). In the "S.E.I." Ledger the amount of the capital payment is entered in the debit column of the Capital columns, and the gross accrued interest purchased in the debit column of the Revenue columns, while the income tax thereon is posted into the credit column of the Revenue columns.

Two control accounts are opened in the General Ledger, viz. Investment Capital Account and Investment Revenue Account, and periodically the totals of the subsidiary Cash Book are

incorporated in the main Cash Book and therefrom posted to these respective accounts.

INTEREST DUE LIST

Each and every month the interest falling due in the month, and, where known, the income tax thereon, that is item (9) on the cards or loose leaves is listed, but in the case of new purchases instead of listing item (9) the second part of item (6) is tabulated, after which this latter information is expunged from the cards or loose leaves by a definite mark in order to avoid confusion in the future as, when running through the cards or loose leaves for listing, the eye will be attracted by a distinctive obliteration and the absence thereof will immediately indicate a new purchase. In the case of those investments where the interest or dividend is a fluctuating quantity, the necessary particulars cannot be entered on the list until the interest or dividend counterfoil is received. The several items comprising the gross interest on the list are posted individually in the "S.E.I." Ledger to the debit of the investment account concerned under the Revenue column and the applicable income tax to the credit column of the Revenue. At the end of each month the total gross interest from this list is posted by means of a Journal entry into the General Ledger to the debit of Investment Revenue Account and to the credit of Interest Account, while the total tax is posted to the credit of Investment Revenue Account and to the debit of Income Tax deducted from Interest Account.

As previously mentioned, the accounts in the "S.E.I." Ledger are sectionalized to conform with the headings for stock exchange investments as shown in the Assurance Companies Act, 1909, and if a company has adopted the method of recording the particulars regarding the investments by utilizing the folio facing the account in the Ledger, the work of extracting from these media the interest due each month would be a formidable task. To avoid scrutinizing item (9) of every folio every month, an additional book is compiled showing under the different months the investments with interest falling due in that month, and the amount of that interest. This book is generally made with fly leaves inserted so as to be available for a number of years and thus defer the rewriting of the details as long as possible.

In the case of the majority of investments a dividend mandate is executed by the company authorizing the interest, or dividend, to be paid direct to the company's bank for the credit of the company. On receipt of the dividends, the bank credits the company's account and forwards to the company the counterfoils, which show the gross interest, the income tax deducted therefrom, and the net proceeds. The company checks the counterfoils against the lists already prepared from the cards, or loose leaves, or the entries appearing in the book referred to in the previous paragraph and inserts in the appropriate column any income tax which was not known when the lists or entries were originally made. Entries for the net proceeds of each dividend, etc., are then made in the subsidiary Cash Book under the Revenue column and from there posted individually to each investment account affected in the "S.E.I." Ledger and in total in the General Ledger to the credit of Investment Revenue Account.

SINKING FUND LIST

At the end of the year the cards, or loose-leaf book, as the case may be, are examined and those investments to which a sinking fund is being applied are listed, item (14). To avoid the labour of wading through all the cards or the loose-leaf book a slight variation of the system can be made by having a special colour for such investments, or the same object can be attained through the instrumentality of a book kept solely for the purpose of recording investments subject to a sinking fund. The items are posted to the credit of the investment concerned in the "S.E.I." Ledger under the Capital column and in total in the General Ledger to the debit of Sinking Fund on Investments Account and to the credit of Investment Capital Account. At the close of the year the Sinking Fund on Investments' Account is transferred by a Journal entry to the debit of Interest Account.

SALE OF INVESTMENTS

When an investment is sold, the broker issues to the company a Sold Contract Note which gives the name of the security, the par value of the stock or the number of shares sold, the price (per cent in the case of stock and the price per share in the case of shares),

the broker's commission, the cost of stamp and the net amount due to the company, also the date of settlement. The majority of sales are made cum-dividend, that is the price received by the vendor theoretically includes the accrued interest to the date of sale less the tax thereon. Where the sale is a cum-dividend one the proceeds have to be divided between Capital and Revenue. These two constituent parts are dealt with in the following manner: The Capital portion is debited in the subsidiary Cash Book and posted therefrom to the credit of the investment account in the "S.E.I." Ledger in the Capital column, similarly with the gross accrued interest less the tax thereon, i.e. the Revenue portion in the Revenue column. The total of the Capital column in the subsidiary Cash Book is transferred to the main Cash Book and from the latter credited to Investment Capital Account in the General Ledger, but as the accrued interest and the income tax thereon in connexion with the sale appear on the same side of the subsidiary Cash Book as the dividend warrants received, they will be included in the totals of the Revenue columns of the subsidiary Cash Book and the General Ledger posting made when these are included in the main Cash Book.

The cards or loose leaves for the investments sold are abstracted from the files, or book, and item (16) second portion, which shows the amount of accrued interest sold and the tax thereon, listed. These items are posted individually to the debit and credit respectively of the relevant investment account in the "S.E.I." Ledger, and in the General Ledger, the total of the gross interest sold is debited to Investment Revenue Account and credited to Interest Account, while the total of the income tax is credited to Investment Revenue Account and debited to Income Tax deducted from Interest Account. The cards, or loose leaves, are then filed away pending the compilation of the Income Tax Return.

To exhibit the effect of all these transactions a card record and a Ledger account as it would appear in the "S.E.I." Ledger are set out on pages 71 and 72.

OUTSTANDING INTEREST, DIVIDENDS AND RENTS

From the specimen account it will be noticed that for the first year the debit and credit columns of the Revenue section of the

AN INVESTMENT RECORD CARD

<u>ACCRUED INTEREST PURCHASED</u> Interest £ 12 : 10 : - Tax Thereon 2 : 16 : 3 <u>Net</u> £ 9 : 13 : 9		Name of Security } <u>LONDON & NORTH EASTERN RAILWAY</u> 5% Redeemable Debenture Stock, 1947 Par Value £1000 : : Country of Origin } <u>British</u> Date Purchased } <u>16th July, 1934</u> Redemption Date <u>1947 (Apr.)</u> <u>Form of Security</u> <u>Registered Stock Certificate</u> Coupons To <u>Talon</u>		<u>INTEREST DUE DATES</u> <u>15th April</u> <u>15th October</u> <u>PERIODICAL INTEREST</u> Interest £ 25 : - : - Tax Thereon 5 : 12 : 6 <u>Net</u> £ 19 : 7 : 6	
<u>PROCEEDS OF SALE</u> Capital £1118 : 5 : 11 Accrued Interest £ 4 : 3 : 4 Tax Thereon : 18 : 9 <u>Net</u> £ 3 : 4 : 7 <u>Total</u> £1121 : 10 : 6 <u>DATE SOLD</u> <u>15th May, 1935</u>		<u>ACCRUED INTEREST TO 31ST DECEMBER</u> Interest £ 10 : 8 : 4 Tax Thereon 2 : 6 : 10 <u>Net</u> £ 8 : 1 : 6			
How Interest } <u>Dividend Mandate to</u> Payable } <u>Lloyds Bank 1.8.1934</u> Annual Sinking Fund } £7 : 16 : 6 Capital Cost } £1090 : - : - Remarks					

¹ In practice this item would be deleted after the 15th October, 1934.
N.B. Had this investment been held until the present, the income tax items in the "Periodical Interest" and "Accrued Interest to 31st December" would have been altered from 4s. 6d. at which they are shown, firstly to 4s. 9d. in 1936, and then to 5s. in 1937, to conform to the standard rate of tax in force for those years.

LONDON AND NORTH EASTERN RLY 5% RED. DEB. STOCK, 1947

		REVENUE				CAPITAL			
		Dr		Cr.		Dr.		Cr.	
		£	s. d.	£	s. d.	£	s. d.	£	s. d.
1934	To Bank Cost of £1000	12 10	—	—	—	10 90	—	—	—
July	" Half-yearly interest and tax	12 10	—	—	—	—	—	—	—
Oct.	By Bank	—	—	2 16	3	—	—	—	—
15	"	—	—	2 16	3	—	—	—	—
16	"	—	—	19	7	—	—	—	—
31	" Sinking Fund	—	—	—	—	—	—	7 16	6
31	" Balance c/d	—	—	—	—	—	—	10 82	3 6
		£25	—	£25	—	£10 90	—	£10 90	—
1935	To Balance b/d	—	—	—	—	—	—	—	—
Jan.	" Half-yearly interest and tax	—	—	—	—	—	—	—	—
15	By Bank	25	—	5 12	6	10 82	3 6	—	—
16	To accrued interest less tax on sale	—	—	19	7	—	—	—	—
May	By Bank Proceeds of sale	4 3 4	—	18	9	—	—	—	—
30	To Profit on Realization	—	—	3 4	7	36	2 5	11 18	5 11
		£29 3 4	—	£29 3 4	—	£11 18	5 11	£11 18	5 11

account are in agreement, and the balance of the Capital column is carried forward to the following year. If the interest had fallen due on the 31st December it is feasible that the payment might not have been credited to the Bank until the following year, in which case the Revenue columns would have shown a debit balance as at the end of the year. This balance would have been carried forward to the next year and would have constituted a part of the asset included in the Balance Sheet designated "Outstanding Interest, dividends and rents." The total of all such balances in the "S.E.I." Ledger should agree with the balance shown on the Investment Revenue Account in the General Ledger.

PROFITS AND LOSSES ON REALIZATION OF INVESTMENTS

Referring again to the Ledger account, it will be observed that after the proceeds of the sale have been entered in the credit column of the Capital section, the Capital Account of the investment shows a credit balance, indicating that a profit has resulted on realization. The account of the investment is therefore closed by a Journal entry crediting Profits and Losses on Realization Account and debiting Investment Capital Account. After posting the cash proceeds of the realization, had there been a debit balance on the account, thus showing a loss on sale, the account would have been closed by debiting Profits and Losses on Realization Account and crediting Investment Capital Account.

INTEREST ACCRUED BUT NOT PAYABLE

At the end of the year item (10) on the cards, or loose leaves, is listed and the list cast to produce the total of the accrued interest to the 31st December. In the case of those securities purchased after the last interest due date, the accrued interest to the 31st December, for the first year only, is reduced by the amount of the accrued interest purchased. There is no difficulty in recognizing new investments as the absence of the obliteration referred to under "Interest Due List" makes them apparent. Only securities having a fixed rate of interest have this item filled in on their cards, or loose leaves. It is not considered necessary to make the entries in the individual investment accounts in the "S.E.I." Ledger, but in

the General Ledger the total gross amount is credited to Interest Account and the total tax debited to Income Tax deducted from Interest Account. The gross accrued interest is brought down on the debit side of the Interest Account for the following year and the income tax thereon brought down on the credit side of Income Tax deducted from Interest Account. The net result of the two balances is shown in the Balance Sheet as part of the asset "Interest accrued but not payable."

DEFAULTED INTEREST

Where a security is in default in paying its interest the card, or loose leaf, is abstracted from the ordinary file and placed in a special "Defaulted interest" file. A note is made in the "Remarks" section of the card to the effect that the interest due on such a date has not been paid, and also this information is temporarily noted on the affected account in the "S.E.I." Ledger.

FOREIGN INVESTMENTS

If the company has any investments in Foreign or Colonial bonds, the actual interest received may vary according to the rate of exchange ruling at the date of payment, in which case an entry is made to the debit or credit of Investment Revenue Account and the opposite entry to the credit or debit of Exchange Account. The information compiled for the cards regarding the periodical interest and the accrued interest to the 31st December is calculated at the nominal rate of exchange. In the case of those securities having, as one of the terms of their issue, a fixed rate of exchange for converting the interest payments into sterling, the relevant details on the cards, etc., are calculated at this fixed rate.

FOREIGN BRANCH INVESTMENTS

Where a foreign branch has authority to invest, the procedure for recording the transactions is similar to that outlined above. In some countries the stock exchange market quotation of a security is the capital price only, so that a purchaser has to pay, in addition to the quoted price, an amount representing the accrued interest to the date of the purchase.

LOANS ON COMPANY'S POLICIES WITHIN THEIR SURRENDER VALUE

Amongst composite companies transacting life business the most prevalent class of investments, after stock exchange investments, are loans granted on the security of their own life policies. On the receipt of an application for a loan of this character, the company, after satisfying itself that the applicant has a clear title to the policy, advances generally nine-tenths of the surrender value of the policy. The cost of any necessary investigation into the title to the policy and also the cost of the stamp on the agreement are borne by the borrower. It is the practice of companies to retain the custody of the policy during the currency of the loan. Usually the interest is made payable half-yearly, and where the premium on the policy is payable annually, some companies arrange for one of the interest due dates to coincide with the renewal date of the policy by calculating the initial interest for the odd period. Other companies arrange the interest to fall due at six-monthly intervals after the date the loan is granted.

A subsidiary Ledger is maintained called the Loans on Life Policies Ledger, or, for short, "L.L.P." Ledger. This Ledger may be ruled similarly to that previously illustrated for the "S.E.I." Ledger, or, alternatively, both these Ledgers may have the debit columns for Capital and Revenue on the left-hand side of the page and the credit columns on the right-hand side with the narrative between. The accounts in the "L.L.P." Ledger are arranged in order of interest due dates and alphabetically, the Ledger being divided into six sections, the first containing those loans the interest on which falls due in January and July, the second for loans with interest falling due in February and August, and so on. Facing each account in the Ledger the undernoted particulars are tabulated—

1. The name and address of the borrower.
2. The date of the deed.
3. The amount of the loan and the rate of interest chargeable.
4. The amount of the half-yearly interest.
5. Various details regarding the policy, viz. the number, the life assured, the sum assured, the date of maturity, the annual premium, the renewal date, and how the premium is collected, i.e. through what branch or otherwise.
6. The dates the interest falls due for payment.

7. The accrued interest from the date of the last interest due date to the 31st December or whatever date the company's year ends.
8. The date the loan is repaid.
9. Remarks column.

With mechanization a card is punched or a plate embossed, giving the name and address of the borrower, the amount of the loan, the rate of interest, the amount of the half-yearly interest and the interest due dates. These cards or plates are filed to correspond with the Ledger accounts, namely, in order of interest due dates, and from them are prepared (1) the list of interest falling due in the month, (2) the debit notes for interest, and (3) the reminders to be dispatched for interest payments in arrear. In some cases the renewal date of the policy is punched on to the card or embossed on to the plate and, as regards the plates, selector pips used to denote the different months in the year. Each month all the cards, or plates, are run through the machine to list the policies falling due for renewal that month, and this list is kept marked up to see that the policies remain in force. For the same purpose, where manuscript Ledgers are used, the policies are entered in a register under the months in which they fall due for renewal.

When the loan agreement is completed and deposited together with the policy at the company's office, the cheque is forwarded to the borrower and an entry made in the subsidiary Cash Book, provided with columns for Capital and Revenue. The amount of the cheque is entered in the Capital column on the credit side of the Cash Book and posted therefrom to the debit column of the Capital account of the borrower in the "L.L.P." Ledger. At periodical intervals, the totals of the subsidiary Cash Book are posted via the main Cash Book, to the debit of Loans on Life Policies Capital Account in the General Ledger. A note is made against the policy in the Policy Register to the effect that a loan has been granted on security thereof.

DEBIT NOTES FOR INTEREST DUE

About a fortnight before the interest is due, debit notes are dispatched to the borrowers, which debit notes, in the case of hand-written accounts, are compiled from the information contained on the folio facing the Ledger account. These debit notes are listed to

produce the monthly list of interest due, but in the case of mechanized accounts these operations are performed mechanically as previously explained. By Rule 19, General Rules, Schedules A, B, C, D, and E, Income Tax Act, 1918, as amended by Section 39 of the Finance Act, 1927, a person, on making an annual payment of interest, etc., wholly out of profits or gains brought into charge to tax, is entitled to deduct therefrom a sum representing the amount of the tax thereon at the standard rate for the year in which the payment becomes due, while under Rule 21 of the same Rules, a person making an annual payment of interest, etc., not payable, or not wholly payable, out of profits or gains brought into charge must deduct thereout a sum representing the amount of tax thereon at the rate in force at the time of payment. Supported by these two regulations, some companies send out debit notes showing the gross interest due, the tax thereon and the net amount due, but the disadvantage of this procedure is the necessity of altering all cards, plates or the folio facing the Ledger accounts, whichever form of record is adopted, whenever there is a change in the standard rate of tax. Other companies, by granting their loans at a rate of interest which is net of tax and which, therefore, does not vary with any alteration in the standard rate of income tax, do not have to make any such adjustments in their records. At the end of the year, such companies gross up the net amount of interest by multiplying it by 1.333 (when the standard rate of tax is 5s.), and the difference between the amounts already credited to Interest Account from the monthly lists and the resultant of this multiplication is credited in the General Ledger to Interest Account and debited to Income Tax deducted from Interest Account.

The individual items constituting the monthly list of interest due are debited in the Revenue column of the borrower's account in the "L.L.P." Ledger and in the General Ledger the total interest is debited to Loans on Life Policies Revenue Account and credited to Interest Account. Where the debit notes are rendered with the appropriate income tax deducted, the monthly lists of interest due incorporate such tax deductions and these are posted in the "L.L.P." Ledger to the credit of each borrower's account in the Revenue column, while the aggregate tax deductions are posted in the General Ledger to the credit of Loans on Life Policies

Revenue Account and to the debit of Income Tax deducted from Interest Account. All cash remittances for interest on loans on life policies are posted in the subsidiary Cash Book and from there into the "L.L.P." Ledger; the totals of the subsidiary Cash Book are transferred periodically to the main Cash Book and from there posted into the General Ledger. The cash is also marked up on the monthly interest due list, which latter is examined at intervals and reminders sent for interest outstanding. At the end of the year, the amount of the accrued interest to the 31st December is extracted from the data on the sheets facing the Ledger accounts and an entry made in the General Ledger, through the medium of the Journal, similar to that made in the case of accrued interest on Stock Exchange investments. Care must be taken to see that the necessary alterations are made in all records whenever an additional loan is granted or a repayment made.

As a means of easily tracing the account in the Ledger and for ready reference a card index of the names of the borrowers, filed in alphabetical order and giving the date the interest falls due, should be maintained.

Where Half Premium Debt or Half Credit Policies are issued, the amounts owing to the company under such policies are included with "Loans on Life Policies" in the Balance Sheet, but in these cases the policy remains in the possession of the assured.

MORTGAGES ON PROPERTY

The Assurance Companies Act of 1909 calls for the segregation in the Balance Sheet of this asset under two headings, namely, mortgages on property situated within the United Kingdom and on property situated out of the United Kingdom, in addition to which those companies also operating in the Irish Free State and amenable to the Irish Free State Assurance Companies Act, 1909, Adaptation Order, 1928, incorporated in the I.F.S. Insurance Act, 1936, have further to divide this class of investment in order to show, as a separate item, the mortgages on property situated in the Irish Free State. The investments in this category together with "Loans on Parochial and other Public Rates," "Loans on Life Interests," "Loans on Reversion," "Loans on Stocks and Shares," and "Loans on Personal Security" are comparatively so few in number that,

in the majority of companies, they can all be accommodated in one subsidiary Ledger. If the property mortgaged is not insured with the company, arrangements should be made to inspect the renewal receipt each year to see that the company's security is not jeopardized by the omission to keep the property adequately insured. In those cases where the mortgage is repayable over a term of years by equal yearly, half-yearly or quarterly instalments to include both principal and interest, a schedule of the payments is drawn up from actuarial tables showing the amount of principal and interest comprising each instalment. Each consecutive instalment will show a reduction in the interest portion commensurate with an increase in the principal portion of instalment.

The method of recording the transactions in connexion with all the classes of investments mentioned above is similar to that adopted for loans on life policies and, therefore, does not require any further explanation.

HOUSE PROPERTY

With nearly all companies this asset represents the book value of the office buildings owned by them, and where the whole of the premises is occupied by the company the income is entirely derived from the rent charged to the underwriting departments, but in other cases, part of the income is obtained from tenants occupying part of the building.

If the company possesses a number of buildings it is an advantage to have a subsidiary Ledger containing a separate account for each building and to maintain two control accounts in the General Ledger, one for the capital transactions, which may be designated Building Capital Account and one for the revenue items, entitled Building Revenue Account.

EXPENDITURE IN CONNEXION WITH BUILDINGS

The initial cost of a building is a capital charge as is also any subsequent expenditure on structural improvements or alterations which add to the value of the building. Expenditure incurred for repairs to a building which ordinarily would be borne by the landlord, that is mainly external repairs, is debited to Building Revenue Account. Expenditure on internal alterations and repairs,

which in the ordinary course would be borne by the tenant, is a trading expense and as such is charged to Expenses Account, unless such expenditure is incurred on behalf of a tenant other than the company, in which case the amount is recouped from the tenant. The amount of rent borne by the Head Office, or branch, for the occupation of the premises is created by a Journal entry debiting Expenses Account and crediting Building Revenue Account, and in the detailed analysis of the expenses the amount is shown under the caption "Rents, Rates, etc." Where there are other tenants in addition to the company a Tenants Account is opened, against which is charged the rent due from each individual tenant, the entry being made as and when the debit notes are dispatched, and the total of these individual items is credited to Building Revenue Account. The cash received from the tenants in payment of their rents is credited to the Tenants Account, so that any balance on this account will represent "Outstanding Rents."

LEASEHOLD PROPERTY

It is customary where leasehold property is owned by the company to take out a leasehold redemption policy to cover the cost of replacing the property when the lease expires and the annual premium on such a policy is placed against the Building Revenue Account.

AMOUNTS WRITTEN OFF BUILDINGS

An examination of the Profit and Loss Accounts for a number of years of the more important insurance companies reveals the liberal amounts that are set aside each year for the writing down of the value of their buildings, the entry being to debit Profit and Loss Account and to credit Building Capital Account. The consistency with which these amounts occur is one of the predominant features of insurance companies' accounts and emphasizes their inherent strength, inasmuch as the value of such buildings as shown in the Balance Sheets is well below their market value.

INCOME TAX, SCHEDULE "A"

Ownership of property carries with it the concomitant liability to income tax. This tax, which is often referred to as property tax, is assessed under Schedule "A" of the Income Tax Act, 1918. The

basis of assessment is the annual value at which the property is worth to be let by the year, which is known as the Gross Annual Value; from this is deducted an allowance for repairs, based on a fixed scale, to arrive at the Net Annual Value and on this latter figure tax is charged. The Net Annual Value is not necessarily the same figure as the rents actually received from the property, and if the net rents receivable are in excess of the Net Annual Value for taxation purposes no additional tax is payable in respect of the property, on the other hand, no taxation relief can be claimed if the net rents receivable are less than the Net Annual Value except under a maintenance claim. Revaluations of property for taxation purposes are made every five years. The Government's financial year runs from the 6th April to the 5th April in the following year and, as the tax under Schedule "A" is payable on the 1st January, that is approximately nine months after the commencement of the financial year, if a company's year ends on the 31st December provision should be made for at least three-quarters of the tax payable on the 1st January, but in practice generally a reserve is made for the whole of the tax liability. In the General Ledger Property Tax Account is debited with the amount of the tax payable, and a Reserve Account credited, which latter account forms part of the omnibus item in the Balance Sheet "Other sums owing by the Company."

Prior to closing the books at the end of the accounting period the balance of the Building Revenue Account is transferred to Interest Account and the balance of Property Tax Account transferred to Income Tax deducted from Interest Account.

CHAPTER VIII

INSURANCE COMPANIES' REVENUE ACCOUNTS

THE Assurance Companies Act, 1909, is the cardinal statute governing the accounts, etc., of insurance companies, and annexed thereto are schedules setting out the forms in which those companies, to which the Act refers, must prepare their revenue accounts for the different classes of business, but before proceeding to study the various revenue accounts it may be as well to become acquainted with some of the provisions of this Act.

THE ASSURANCE COMPANIES ACT, 1909

Section 1 delineates the companies affected and states that insurance companies who carry on, within the United Kingdom, assurance business of all or any of the under-mentioned classes are subject to the regulations of this Act—

(a) Life assurance business, including the granting of annuities upon life.

(b) Fire insurance business.

(c) Accident insurance business, that is, any class of personal accidents, disease, or sickness insurance.

(d) Employers' liability insurance business.

(e) Bond investment business, that is, the issuing of bonds by which the company in return for subscriptions payable at periodical intervals of two months or less, contract to pay the bondholder a sum at a future date.

Section 2 intimates that those companies coming within the purview of the Act must deposit and keep deposited with the Paymaster-General for and on behalf of the Supreme Court the sum of £20,000. This sum is invested by the Paymaster-General in securities approved by the Court and selected by the company and the interest or dividends thereon are paid to the company. Those companies carrying on assurance business of more than one class are required to deposit a separate sum of £20,000 for each class of business, but so far as the under-mentioned classes of business are concerned, the enactment

regarding a separate deposit for each class of business is subject to the following modifications—

Fire Insurance. If a company has made a deposit in respect of any other class of assurance it is exempt from making a deposit in respect of fire business. (Section 31 (d).)

Accident Insurance. If a company has made a deposit in respect of any other class of assurance it is exempt from making a deposit in respect of accident business. (Section 32 (c).)

Employers' Liability Insurance. As soon as the Employers' Liability Fund amounts to £40,000 the Paymaster-General shall return to the company its deposit of £20,000 if it has a deposit in respect of any other class of business. (Section 33 (e).)

Bond Investment Insurance. The same modifications apply as to Employers' Liability business. (Section 34 (c).)

By Sections 31 (b), 32 (b), and 34 (b), respectively, companies which were transacting fire, accident, and bond investment business before the passing of the Act (3rd December, 1909) are exempt from the provisions of the Act relating to deposits for those classes of business, and by Section 33 (d) a similar privilege is extended to companies transacting employers' liability business before the 28th August, 1907.

If a company has made a deposit in respect of fire business (Section 31 (d)) or accident business (Section 32 (c)), and subsequently commences to do either life or employers' liability insurance, it may have the original deposit transferred to the life or employers' liability business as the case may be, and is then exempt from making a deposit in respect of the fire or accident business.

The Board of Trade Order dated 6th June, 1910, No. 566, gives the mode of procedure to be adopted when making a deposit, and the rules under that Order are as follows—

The company may make application to the Board of Trade for a warrant, which, when issued, is the authority for (a) the company to lodge the money mentioned therein at the Bank of England to the account of the Paymaster-General, for and on behalf of the Court ; (b) the Paymaster-General to issue directions to the Bank to receive same to be placed in the books of the Paymaster-General to the credit of *ex parte* the company, according to the method for the time being in force respecting the lodgment of money.

Wholly or partly in lieu thereof, the depositors may bring into Court (i.e. the Supreme Court of Judicature) an equivalent sum of such stocks, funds or securities as the Court at the time are permitting cash under their control or order to be invested in. The value of such stocks, etc., is taken at a price as near as may be to, but not exceeding, the current market price. (Rule 2.)

In the case of those businesses which require the keeping of separate assurance funds (i.e. life, employers' liability and bond investment) the application to the Board of Trade and the warrant shall specify the particular class of business for which the deposit is being made, and the deposit shall be marked accordingly in the books of the Paymaster-General to a special Ledger credit. (Rule 3.)

Where such a deposit has been made, on application of the company, the Court may order—

(a) Investment in such stocks, funds or securities as the company desire and the Court thinks fit, and either by way of original investment or by way of variation of investment.

(b) Payment to the company of the interest, dividends or income from time to time accruing due on such investments.

(c) In the cases provided for by Rules 6 and 7 following, the transfer or payment of the deposit either from one Ledger credit of the company to another or out of Court. (Rule 4.)

In any case where it may appear to be just and equitable so to do, and particularly in the under-mentioned circumstances, on application of the company the Court may order the deposit to be transferred from the general account of the company to a special Ledger credit for a particular class of business, or from one special Ledger credit to another—

(1) Where a company having a deposit standing to its credit generally intends subsequently to carry on assurance business which requires the keeping of a separate fund.

(2) Where a company having carried on employers' liability or bond investment business and having a deposit standing to a special Ledger credit in respect thereof, has a fund amounting to £40,000 secured for such policy-holders, and intends subsequently to carry on in the first case bond investment, or in the second case employers' liability, or in either case life assurance. (Rule 6.)

In the following cases and, where it may be just and equitable so to do, on the application of the company, the Court may order the deposit to be paid or transferred out of Court and returned to the company—

(a) Where a company has a deposit standing to the credit of the

company generally for either fire or accident business or both, makes a further deposit in respect of any other class of assurance business.

(b) Where a company has a deposit to a special Ledger credit in respect of employers' liability business and the employers' liability fund amounts to £40,000 and the company makes a further deposit in respect of any other class of assurance business as provided for in Section 33 (e) of the Act.

(c) Similarly as regards bond investment business under Section 34 (e) of the Act.

(d) Where a company has ceased altogether to carry on within the United Kingdom either assurance business of any class, or the particular class for which a special Ledger credit is standing (provided it is not the sole deposit) and all liabilities in respect of the deposit have been satisfied or otherwise provided for. (Rule 7.)

Any application under Rule 6 or 7 shall be served on the Board of Trade. (Rule 9.)

Rule 10 states that so far as deposits have been made under the provisions of the Life Assurance Companies Acts, 1870 to 1872, and the Employers' Liability Insurance Companies Act, 1907, they shall be treated as having been made under the Act, and further authorizes the transfer to a corresponding account of the Accountant-General of the Supreme Court of Judicature in Ireland of deposits so made by an Irish Company.

Section 3 of the Assurance Companies Act, 1909, deals with the keeping of separate funds, and subsection (1) thereof gives the circumstances in which separate funds must be established, enacting that where an assurance company transacts other business besides that of assurance, or transacts more than one class of assurance business, it is necessary to keep a separate account for the assurance business or for each class of assurance business, as the case may be, and the receipts from each class of assurance business must be carried to a separate assurance fund, appropriately named, but it is not necessary to segregate the investments representing the funds. Subsection (2) decrees that a fund so created is the absolute security of the policy-holders of the fund and shall not be applied, directly or indirectly, for any purposes other than those of the class of business to which the fund is applicable.

Section 31 (e) and 32 (d), respectively, provide that separate funds need not be kept for fire business and accident business, this exemption arising from the fact that a company's liability under these classes of business is not a continuing liability and consequently

the funds belonging to these classes of business are not in the nature of trust funds.

Under Section 4 of the Act every assurance company must prepare at the expiration of each financial year of the company—

(a) A Revenue Account in the form set forth in the First Schedule to the Act for each class of assurance business.

(b) A Profit and Loss Account in the form set forth in the Second Schedule to the Act.

(c) A Balance Sheet in the form set forth in the Third Schedule to the Act.

Four copies of the accounts and Balance Sheet, one of which must be signed by the Chairman, two directors and the principal officer of the company and also by the Managing Director if such there be, must be deposited with the Board of Trade within six months after the close of the period to which the accounts relate. The Board of Trade has power to extend this period for a further three months if circumstances warrant such extension. (Section 7 (1).)

Any report on the affairs of the company submitted to the shareholders or policy-holders must be deposited with the accounts and Balance Sheet. (Section 7 (3).)

Subsection (4) of Section 7 provides that where an assurance company registered under the Companies Act deposits its accounts and Balance Sheet with the Board of Trade, it may send to the Registrar of Companies a copy of the same, which will be taken as complying with Section 26 (3) of the Companies (Consolidation) Act, 1908. This latter enactment, of course, is now re-enacted by Section 110 (3) of the Companies Act, 1929.

Section 8 entitles any shareholder or policy-holder, on application, to be supplied with a printed copy of the last deposited accounts, Balance Sheet, abstract or statement.

Section 5 deals with the actuarial valuation and lays down that at least once in every five years an actuary must investigate the financial condition, including a valuation of the liabilities, of every assurance company (this is generally known as the quinquennial valuation) and an abstract of the actuary's report must be made in the form set forth in the Fourth Schedule (A) to the Act.

Section 6 decrees that every assurance company must prepare a

statement of its assurance business at the date to which the accounts are made up for the purpose of the investigation referred to in Section 5, in the form set forth in the Fifth Schedule.

The qualifications to Sections 5 and 6 for the various classes of business are as under—

Sections 5 and 6 of the Act do not apply to fire insurance business. (Section 31 (a).)

Section 32 (a) decrees that where a company carries on personal accident business, in lieu of Sections 5 and 6, a statement must be prepared annually of its accident claims paid and outstanding in the form set forth in the Fourth Schedule (C). The statement must be printed, signed and deposited with the Board of Trade in the same manner as the annual Balance Sheet and accounts.

Section 33 (c) states that where employers' liability insurance is transacted, in lieu of Sections 5 and 6, the company must prepare annually a statement of its employers' liability claims paid and outstanding in the form set forth in the Fourth Schedule (D), and if necessary, to enable the provisions of the form to be complied with, an investigation of its estimated liabilities must be made by an Actuary. The statement must be printed, signed and deposited with the Board of Trade in the same manner as the annual Balance Sheet and accounts.

The rules relating to the custody, inspection and certification of documents required under the Assurance Companies Act, 1909, are contained in the Board of Trade Order of 6th June, 1910, No. 566 to wit—

1. A copy of every account, Balance Sheet, abstract, statement or report required by the Assurance Companies Act, 1909, to be deposited with the Board of Trade shall be kept by the Registrar of Companies, and shall be open to inspection by any person on payment of a fee of 1s. for each inspection, and any person may procure a copy of such document or any part thereof on payment of 4d. a folio of 72 words.

2. The Assistant Registrars are hereby appointed (in addition to the Registrar) for the purpose of certifying documents under Section 21 of the said Act.

The Irish Free State Adaptation of Enactments Act, 1922, Adaptation Order, 1928, adopted the British Assurance Companies

Act, 1909, *mutatis mutandis*, but subsequently the Irish Free State passed an insurance act of its own, embodying certain features of the Assurance Companies Act, 1909, and known as the Irish Free State Insurance Act, 1936.

THE IRISH FREE STATE INSURANCE ACT, 1936

This Act legislates for the control of life, industrial, fire, accident, bond investment, employers' liability, mechanically propelled vehicle, public liability, engineering, glass, guarantee and burglary insurance business carried on in the Irish Free State. As the majority of British companies have branches in the Irish Free State it would seem desirable to give some consideration, at this stage, to the various regulations in the Act dealing with accountancy matters affecting such companies.

The first section of the Act intimates that the I.F.S. Assurance Companies Act, 1909, and this Act may be cited together as the Insurance Acts, 1909 and 1936.

Section 7 repeals, as from the commencement of Part II of the Act, those sections of the 1909 Act which exempt, under certain conditions, companies transacting fire, accident, employers' liability and bond investment business from making deposits. Subsection (3) abrogates from the commencement of Part VII of the Act the privilege of not segregating the investments representing the various assurance funds, i.e. subsection (1), Section 3 of the 1909 Act. But the latter is qualified by Section 105 (5) which enacts that where a company carries on more than one class of assurance business other than life and industrial business it shall be under no obligation to keep the assets of the different funds separate.

Primarily the Act prohibits the carrying on of life assurance business in conjunction with other classes of insurance business (Sections 12 and 15) and makes the possession of a licence a precedent to the transacting of assurance business.

Section 12, subsections (7) and (8), stipulates the conditions under which a company incorporated outside the Irish Free State is entitled to apply for an assurance licence, viz.—

(i) The company carried on the business in the Irish Free State on the 31st October, 1935.

(ii) The company complies with the provisions of the I.F.S. Assurance Companies Act, 1909.

(iii) The company had on the 31st October, 1935, and has on the date of the application a place of business in the Irish Free State.

(iv) The company complies with the provisions of Section 274 of the I.F.S. Companies (Consolidation) Act, 1908, which applies to every company incorporated outside the Irish Free State and establishing a place of business within the Irish Free State, but the only clauses in this section affecting existing companies are those which provide that any alterations in the following particulars shall be filed with the registrar—

(a) the charter or other instrument constituting the company,

(b) the list of the Directors,

(c) the names and addresses of the person or persons resident in the Irish Free State authorized to accept service of process. Such companies also in every year must file with the registrar a statement in the form of a balance sheet.

Every such company which uses the word "Limited" as part of its name shall—

(a) in every prospectus issued in the I.F.S. state the country in which the company is incorporated,

(b) in every place where it carries on business in the I.F.S. conspicuously exhibit the name of the company and the country where it is incorporated,

(c) have the name of the company and the country in which it is incorporated mentioned in all bill-heads and letter paper and in all notices, advertisements and other official publications of the company.

Section 12 also provides that those companies which carried on both life and another or other classes of insurance business prior to the date the Act came into operation may be granted a temporary licence, for a maximum period of nine months, for both life and the other classes of assurance, pending the transfer of one or the other to a company licensed under the Act to carry on such business.

The deposits to be made with the Accountant of the Courts of Justice by every company which carries on or proposes to carry on assurance business in the I.F.S. are set out in Section 22 and may be summarized as follows—

£20,000 in respect of life assurance business.

£20,000 in respect of industrial assurance.

£20,000 in respect of any one or more of fire, accident, bond investment, employers' liability, public liability, engineering, guarantee, and burglary insurance business.

£15,000 in respect of mechanically propelled vehicle insurance. In the case of a company transacting glass insurance only, no deposit is required.

Section 24 authorizes a deposit made under the I.F.S. Assurance Companies Act, 1909, to be utilized as a deposit for the same class of business required under this Act. Subsection (2) states that at the commencement of this part of the Act the Accountant of the Courts of Justice must ascertain and give notice in writing to a company of the market value of the investments then held by him as a deposit, and should that value be less than that required under this Act, the company must make up the deficit within one month from receipt of the notice. If the market value exceeds the required amount, the company may, within three months from receipt of the notice, apply for payment of the excess. The High Court will then either authorize the Accountant of the High Court to sell so much of the investments as will leave the market value of the residue equal to the amount of the deposit required and to pay to the company the proceeds less the costs, or, if requested by the company, direct the Accountant of the Courts of Justice to transfer investments to the value of the excess either to the company or to some person nominated by the company.

Where a company ceases to carry on any particular class of assurance business in respect of which a deposit is maintained, the company may apply to the High Court for the release of such deposit and, provided the High Court is satisfied that the deposit is not required for any other class of assurance business and that either the liabilities in the I.F.S. in respect of such business have been met and discharged or security has been given to the Accountant of the Courts of Justice, the High Court will order the transfer of the said investments to the company. (Section 26.)

Part VI of the Act, Sections 77 to 90, deals with the Reinsurance Company of Ireland, Limited, which is a company to be formed and registered at the instigation of the Minister of Finance for the purpose of reinsuring risks entered into by assurance companies. Section 89 compels every insurance company which affects assurance business in the Irish Free State, but excluding those transacting life and industrial assurance, so far as it reinsures, to enter into an agreement with the Reinsurance Company of Ireland, Limited, to reinsure

with that company. This includes the reinsurance of renewals when the original contract was entered into before the commencement of this part of the Act.

A pooling arrangement has been made between the British Tariff Offices and the Irish Tariff Offices, the effect of which is to secure a substantial income by way of reinsurance premiums to the latter. It has been agreed that as long as the pooling scheme is operating to the satisfaction of the Minister for Industry and Commerce this part of the Act, viz. Part VI, will not be put into force.

For the first ten years of the company's existence the Irish Free State Government will guarantee every reinsurance contract entered into by the company, but no right of action shall lie at the suit of the company or of any assurance company against the Irish Free State Government under such guarantee. (Section 90.)

Section 92 empowers an assurance company, which is required by the I.F.S. Assurance Companies Act, 1909, or by this Act to maintain an assurance fund, to borrow money and/or to issue debentures, etc., on security of such fund, provided the moneys so borrowed and secured are applied solely for the purposes of that class of assurance business in respect of which the fund is maintained.

Section 93 intimates that all claims under policies issued after the commencement of this part of the Act in the Irish Free State by an assurance company carrying on business in the Irish Free State to a person ordinarily resident in the Irish Free State, shall be paid and payable in the Irish Free State.

Form (A) of the Fifth Schedule to the I.F.S. Assurance Companies Act, 1909, which is applicable to life business, is amended by Section 95 by inserting a paragraph numbered 4A after 4, requiring similar information for pure endowments as that already given for endowment assurances under paragraph 4, and as a consequence paragraph 7 is deleted.

Authority is given under Section 96 to the Minister of Industry and Commerce, after consultation with such assurance companies as he thinks fit or with any association representing assurance companies, to alter all or any of the schedules to the Act or to all or any of the Schedules of the 1909 Act relating to companies.

By Section 97 the Minister of Industry and Commerce is permitted, if he considers fit, to accept from a foreign company operating

in the Irish Free State the returns such company has to make to its own Government in lieu of the accounts, Balance Sheets, abstracts and statements called for under the Act of 1909 and the present Act.

Every assurance company has to furnish to the Minister of Industry and Commerce, within six months after the end of every accounting year, a return showing, in respect of each class of assurance business other than life and industrial business, the amounts of the Irish Free State premiums and claims which it has reinsured during the year and the amounts of Irish Free State premiums and claims which it has accepted by way of reinsurance during the year. Also, a company transacting life and/or industrial assurance business has to furnish a return, within the same time limit, showing the sums debited and credited during the year for reinsurance in respect of Irish Free State business, set out to show the premiums, sums assured and claims arising by death or maturity, and by surrenders. (Section 98.)

Section 100 calls for the following additional particulars in respect of all classes of business carried on in the Irish Free State to be contained and set forth in the revenue accounts deposited in accordance with Section 7 of the I.F.S. Assurance Companies Act, 1909—

(a) Under separate headings for business in the Irish Free State and business out of the Irish Free State, the premiums credited, commission, claims paid and claims outstanding, expenses of management and other income and expenditure in the Irish Free State, and

(b) The amount (apportioned as nearly as may be) of the expenses outside the Irish Free State attributable to the Irish Free State business, and

(c) The amount of the outstanding premiums in respect of Irish Free State employers' liability and mechanically propelled vehicle insurance business which have been credited in the account.

The same persons as are required to sign the Balance Sheet have to sign an additional certificate incorporating the following points, and this has to be appended to the Balance Sheet—

That the values of all the assets have been ascertained and reviewed as at the date of the Balance Sheet and that in their belief they are shown at amounts which do not exceed in the aggregate the realizable or market value of such assets after taking into account any investment reserve fund. That the mortgages and loans are in their belief in the

aggregate adequately secured. Where the aggregate book value of the Stock Exchange investments, after taking into account any investment reserve fund, is in excess of the market value, explain how the book values have been arrived at. Explain any increase over the previous year in the book value of freehold and leasehold property not due to additional purchases.

A further certificate signed by the same persons and also by an actuary has to be appended, certifying that the values of reversions and life interests have been ascertained and reviewed as at the date of the Balance Sheet, and that in their belief the aggregate value thereof shown in the Balance Sheet is not in excess of the actuary's valuation. (Section 101.)

Section 102 enacts that foreign companies carrying on life and/or industrial assurance, in addition to the statements required under Section 6 of the Act of 1909, shall prepare similar statements for Irish Free State business only, which statements shall be subject to the provisions of Section 7 of the 1909 Act.

Companies transacting mechanically propelled vehicle insurance are required to prepare annually a statement of the estimated liability in respect of Irish Free State outstanding and unsettled claims. (Section 103.)

Section 104 intimates that the I.F.S. Assurance Companies Act, 1909, shall apply to companies carrying on one or more of the following classes of business, public liability, engineering, glass, guarantee and burglary insurance, but with the following modifications—

(a) Sections 5 and 6 shall not apply. That is, a quinquennial valuation in the forms of the Fourth and Fifth Schedules is not required.

(b) The companies shall annually prepare one statement of its assurance business in such form as the Minister for Industry and Commerce shall from time to time direct.

(c) Section 32 (d), (e), (f), and (g) shall apply with the substitution of the names of the various classes of assurance business in lieu of the word "Accident."

Note. Section 32 (d) absolves a company from keeping separate funds into which all receipts in respect of such class of assurance business are to be paid.

Section 105 states that—

(1) Where a company maintains a separate assurance fund in pursuance of Section 3 of the 1909 Act, all moneys received in respect of such class of business shall be carried to the separate fund and to no other fund.

(2) Where a company carries on life and/or industrial assurance business in the Irish Free State and also carries on any other class of business except sinking fund or capital redemption business, it shall keep the assets of its life and its industrial funds separate from the assets of its other business.

(3) Where a company carried on life and/or industrial assurance business in the Irish Free State on the 31st October, 1935, and continues to carry on after the commencement of Part II of the Act, on application of the company, the Minister of Industry and Commerce may grant exemption from complying with the provisions regarding segregation for a period not exceeding twelve months after the commencement of this part of the Act.

(4) Where a company carries on both life and industrial assurance business there is no obligation to keep the assets of each class separate.

Power is given to the Minister of Industry and Commerce, whenever he thinks proper, to prohibit the reinsurance of any class of assurance effected in the Irish Free State (other than life and industrial) with any company other than one carrying on that business in the Irish Free State (Section 106), but subsection (5) empowers the Minister to exempt a company provided it has arranged with one or more Irish Free State companies to reinsure the business.

LIFE BUSINESS

Coming to the Revenue Accounts, on the next page is given a copy of the First Schedule to the Assurance Companies Act, 1909, which is the Revenue Account for life and annuity business.

The singular features about the Revenue Account are that, contrary to the orthodox accountancy practice the income, profits and gains are shown on the left-hand side of the account and the outgo, losses and expenses, on the right-hand side, and the prefixes "To" and "By" are omitted. Further, it will be noticed that the whole of the life assurance is classified into "Business within the United Kingdom" and "Business out of the United Kingdom." Before the Irish Free State Insurance Act, 1936, came into operation, the Irish Free State, having adopted, with the requisite alterations, the British Assurance Companies Act, 1909, enforced those companies conducting life insurance in the Irish Free State further to dissect their business so as to show that within the Irish Free State. The majority of such companies, therefore, had the following headings, "Business within the United Kingdom," "Business within the Irish Free State," "Business out of the

FIRST SCHEDULE

N.B. Where marine insurance business or sinking fund or capital redemption insurance business is carried on, the income and expenditure thereof to be stated in like manner in separate accounts. Any additional businesses (including employers' liability insurance business transacted out of the United Kingdom) to be shown in a separate inclusive general account.

(A) FORM APPLICABLE TO LIFE ASSURANCE BUSINESS

Revenue Account of the.....for the Year endingin respect of Life Assurance Business			
—	Business within the United Kingdom	Business out of the United Kingdom	TOTAL	Business within the United Kingdom	Business out of the United Kingdom	TOTAL
	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.
Amount of life assurance fund at the beginning of the year				Claims under policies paid and outstanding— By death By maturity		
Premiums—				Surrenders, including surrenders of bonus Annuities Bonuses in cash Bonuses in reduction of premiums Commission Expenses of management		
Consideration for annuities granted				Other payments (accounts to be specified)		
Interest, dividends, and rents	£ s. d.			Amount of life assurance fund at the end of the year, as per Third Schedule		
Less income tax thereon						
Other receipts (accounts to be specified)						

NOTE 1. Companies having separate accounts for annuities to return the particulars of their annuity business in a separate statement.
 NOTE 2. Companies having both Ordinary and Industrial branches to return the particulars of the business in each department separately.
 NOTE 3. Items in this Account to be net amounts after deduction of the amounts paid and received in respect of reassurances of the Company's risks.
 NOTE 4. If any sum has been deducted from the expenses of management account, and taken credit for in the Balance Sheet as an asset, the sum so deducted to be separately shown in the above Account.
 NOTE 5. Particulars of the new life assurances effected during the year of account to be appended to the above Account showing separately, as respects business within and business out of the United Kingdom, the number of policies, the total sums assured, the amount received by way of single premiums, and the amount of the yearly renewal premium income, the items to be net amounts after deduction of the amounts paid and received in respect of reassurances of the company's risks. The particulars as to yearly renewal premium income need not be furnished in respect of Industrial business.
 NOTE 6. The columns headed "Business out of the United Kingdom," in the case of companies having their head office in the United Kingdom, apply only to business secured through Branch Offices or Agencies out of the United Kingdom.

United Kingdom and Irish Free State" and "Total." Those companies continuing to write business in the Irish Free State subsequent to the Irish Free State Insurance Act, 1936, coming into operation will find it necessary to vary their methods of recording such business so as to enable them to conform to the more stringent regulations and to produce the additional information required by that Act, and it may be expedient to consider such variation independently. Therefore, to avoid possible confusion, the arrangement will be to discuss each separate Revenue Account from the point of view of the Assurance Companies Act, 1909, and immediately thereafter to examine the Revenue Account for the same class of business transacted in the Irish Free State.

AMOUNT OF LIFE ASSURANCE FUND AT THE BEGINNING OF THE YEAR

Taking the component items of the account *seriatim*, the first is "Amount of Life Assurance Fund at the beginning of the year"; this, of course, is the balance brought forward from the previous year. Some companies, who apportion neither their expenses nor their interest between the "United Kingdom" and "Other business," merely extend the whole of the fund into the total column, while others, more or less strictly complying with the *pro forma* account, keep their funds in such a manner as enables them readily to show the amount under each category.

PREMIUMS

The next item is "Premiums." Note (3) at the foot of the specimen account states that all items in the account are to be net after deduction of reinsurance and, *en passant*, it may be mentioned that a similar note appears at the foot of each of the Revenue Accounts. If the reinsurance premiums have been posted to the debit of Life Premiums Account, the balance of this account will be transferred by Journal entry to the Revenue Account and will represent all premiums falling due during the year. On the other hand, if a Reinsurance Premiums Account has been opened it will be closed by transferring the balance to Life Premiums Account and then the balance of the Life Premiums Account will be transferred to Revenue Account. There are two methods of arriving at

the figures for the necessary classifications, the one whereby separate accounts are opened in the General Ledger for each class of business, viz. "United Kingdom Life Premiums" and "Outside U.K. Life Premiums," and the other whereby one premium account is maintained and the respective figures are arrived at by analysis. This Revenue Account includes all classes of business, so that where "With Profits," "Guaranteed Bonus," "Non-Bonus," etc., policies are issued, it is necessary for valuation purposes either to have separate Premium Accounts for each class or to obtain the information by analysis, but whichever system is in operation the item "Premiums" in the Revenue Account must include the total of all premiums written. Where half-premium debt policies are issued, the whole of the premium is included in the Premium Account and an entry made for that portion of the premium on loan to the credit of the assured, either through the agent's account or direct, and to the debit of Half Premium Debt Account, the total of which account, as previously stated, is included in the Balance Sheet with the item "Loans on the Company's policies within their surrender values."

Note 2 at the foot of the account requires companies doing both ordinary and industrial business to return the particulars of each department separately.

CONSIDERATION FOR ANNUITIES GRANTED

The company has the option either to keep separate revenue accounts and funds for annuity business, or to combine the annuity business with that for life, but footnote 1 states that companies having separate accounts for annuities are to return the particulars of their annuity business in a separate statement.

This item, "Consideration for annuities granted," represents the purchase price payable to the company for annuities. The assured pays a lump sum to the company in return for which he receives an annual sum, payable quarterly, half-yearly or yearly for a specified period or until death occurs, according to the terms of the contract. The consideration in connexion with deferred annuities, that is annuities commencing at some future date, is often made by periodical payments. The Annuity Consideration Account in the General Ledger is closed by a Journal entry transferring the balance

of the account to the Revenue Account. The consideration paid for annuities certain, that is annuities payable for a definite number of years independent of any life, is not included under this heading.

INTEREST, DIVIDENDS AND RENTS, LESS INCOME TAX THEREON

The gross amount of interest and the income tax applicable thereto are shown short and the net result extended to the account columns. The income tax figure in the case of the majority of companies includes not only both the income tax deducted at source and that payable on assessment, but also any foreign tax on such interest. Where the investments representing the life and annuity funds are segregated the items of gross interest and tax thereon are obtainable readily from the Ledger accounts "Interest (Life and Annuity business)" and "Income tax on Interest (Life and Annuity business)," as these accounts are kept distinct from other interest and tax thereon. Where the investments are not segregated, the items are obtained by apportioning the total gross interest and the tax thereon, either on the basis of the mean funds or on some other arbitrary basis. Unless the segregation of investments is extended to the different classes of business, that is, business in the United Kingdom and out of the United Kingdom, it is customary to show the figure for interest less tax in the total column only.

How the figure for tax deducted at source is arrived at has been explained in Chapter VII and it is now necessary to make a digression to consider how the tax on assessment is found.

Rule 15 (1) of Cases I and II of Schedule "D" of the Income Tax Act, 1918, enacts that where an assurance company carries on life assurance business in conjunction with assurance business of any other class, the life assurance business shall, for income tax purposes, be treated as a separate business, and Section 16 (3) of the Finance Act, 1923, provides that ordinary and industrial business are also to be treated separately.

A life assurance company is taxed either on its investment income or on its profits, whichever is the greater.

In the Finance Act, 1923, Section 16 (1), it is provided that in computing the profits of a life assurance company such part of

those profits as belongs to the policy-holders or annuitants shall be excluded in making the computation, and, as a result, practically all ordinary life business is taxed on the investment income basis.

According to Rule 21 (3) of the General Rules applicable to Schedules A, B, C, D, and E, Income Tax Act, 1918, an assurance company is entitled to treat as having been paid out of profits or gains brought into charge to tax, the annuities paid up to an amount not exceeding the amount of the taxed income of its annuity fund. This means that when the amount of annuity payments subject to tax deduction is such that the total tax deducted therefrom is equal to, or in excess of, that calculated at the standard rate on the amount of the interest of the Annuity Fund, that interest virtually becomes tax free.

Section 33 of the Income Tax Act, 1918, enacts that an assurance company carrying on life business, which has been assessed on interest and not on profits, shall be entitled to repayment of tax on any sums disbursed as expenses of management including commissions, provided that the amount of fines, fees or profits arising from reversions shall be deducted from the expenses of management, but any losses on reversions may be set off against any profits on reversions. The relief given under this Section is limited to the extent that it shall not make the tax payable by the company less than would have been paid if the company had been assessed on the basis of its profits. Section 16 (2) of the Finance Act, 1923, decrees that the profit arising from the granting of annuities shall also be deducted from the expenses of management, but there may be set off against such profits any loss on annuities. It was held in *North British & Mercantile Insurance Company v. Easson*, [1919] C.S., 7 Tax Cas. 463, that, where a scheme was instituted whereby an assurance company insured the members of a society at a discount of 15 per cent from the ordinary premium, the company crediting the gross premiums to Premium Account, and debiting the discount to expenses of management, the discount could not be allowed for the purpose of a claim to relief under this Section. Relying upon this decision the Inland Revenue treat any discounts allowed by an assurance company under Staff Assurance Schemes as a rebate or discount on premiums and not as commission, and thus exclude them from the company's claim for relief in respect of management

expenses (including commission). Incidentally it may be mentioned that the practice has grown up of treating broker's commission, stamp duties, and fees pertaining to the purchase and sale of stocks and shares as items admissible as management expenses (including commission) for the purposes of Section 33 of the Income Tax Act, 1918.

Section 33 of the Finance Act, 1933, decrees that where the relief for expenses of management has been reduced owing to the amount of tax payable by the company being less than the tax which would have been payable if the company had been assessed on the basis of profits, the amount of expenses disallowed may be carried forward to the next six years' assessments until the amount has been absorbed. This applies to any year of assessment after the year 1932-3.

Section 46 (2) of the Income Tax Act, 1918, enacts that where certain securities, which the Treasury have power to issue free of tax when in the beneficial ownership of persons not ordinarily resident in the United Kingdom, form part of the investments of a company's foreign life fund they shall not be liable to tax. Such securities are 4% Funding Loan 1960-1990, 4% Victory Bonds, 3½% War Loan and British Government War Securities issued abroad. Should an assurance company, having a foreign life fund and hypothecating specific securities to its various funds, possess any of these securities it is obviously to the company's advantage to apply such securities to its foreign life fund. In cases where hypothecation is not carried out and the company possesses any of these securities, the Inland Revenue, as a concession, generally allows such securities to be considered as forming the investments of the foreign life fund.

In computing the relief due under Section 33 an allowance must be made for any relief obtained under Section 46 (2).

For the purposes of assessing a life office on a profit basis, the profit is taken as being that part of the surplus not belonging to the policy-holders, as disclosed at the last valuation. Where the valuation is a quinquennial one, one-fifth of such surplus is treated as being the annual profit for the succeeding five years and an adjustment is made at the end of that quinquennial period.

With a few minor exceptions, the present basis of assessing to tax interest not taxed at source is the amount arising in the preceding

year, so that the provision for tax made in the current year's accounts is based on the preceding year's untaxed interest, while the tax is payable on the following 1st January. A Journal entry is made debiting Income Tax on Interest Account with the amount of the tax on assessment and crediting a provision account, which latter account is shown as a liability in the Balance Sheet under the heading "Other sums owing by the company." Claims under Sections 33 and 46 of the Income Tax Act, 1918, cannot be formulated until the close of the year's accounts, consequently any repayments received under these Sections during the current year will relate to the previous and/or prior years' business. As repayments under Section 33 can only arise where a company is assessed on its interest earnings, the prevailing practice is to credit any recovery under this Section to Income Tax on Interest Account, although there are instances where the recovery is taken to reduce the Expenses Account.

In computing the amount of interest for assessment, only that actually received as interest is taken into consideration, any accrued interest on either sales or purchases of investments being ignored, *vide Wigmore (Inspector of Taxes) v. Summerson & Sons, Ltd.*, [1926] 1 K.B. 131 9 Tax Cas. 577, and *Commissioners of Inland Revenue v. Oakley*, [1926] 1 K.B. 137 9 Tax Cas. 582. Immediately one conceives the notion that, by selling all investments when they are full of dividend and repurchasing as soon as they become ex-dividend, it would be possible for a life company to avoid attracting any liability for tax in assessment on its interest, but the 1937 Finance Act contains a clause practically prohibiting such legal evasion. However, even prior to the prohibition of "Bond-washing," as such device is termed, the company would have gained no advantage from such machination because the effect would have been that its profits would have exceeded its interest income, and an assessment would have been raised on a profits basis. Further, having regard to the number of investment movements, undoubtedly it would have been held that the company carried on a trade in investments with the concomitant assessment to tax of the balance of the profits over losses on realization of such investments. It was held in *Thompson (Inspector of Taxes) v. Trust and Loan Company of Canada*, [1932] 1 K.B. 283, 16 Tax Cas. 394, that, in arriving

at the profit or loss on realization of investments for taxation purposes, the difference between the actual cash paid and received had to be taken, irrespective of any accrued interest included in either of the amounts. Thus while the accrued interest sold would not have been subject to taxation in its character as interest, to the extent that it augmented the proceeds of a sale, it would be saddled with liability to tax as part of the profit on realization. There is also the possibility that the reinvestment could not be made on as favourable terms as the original investment, but, on the other hand, against this deterrent the market might have fallen in the interim between the date of the sale and the time for reinvesting, enabling the company to "get in" on better terms. The practice would have certain drawbacks, such as the multiplicity of brokers' charges which would be incurred and the clerical labour involved in the recording of the transactions and the supervision of the investments.

Before leaving the subject of taxation, it should be noted that the Income Tax Authorities do not allow as a charge against interest any amounts applied as sinking fund. Therefore, it is not to the benefit of a life company, or a composite company which segregates its investments for the life department, to invest in a redeemable security at a price above the redemption value, as, assuming the company follows the canons of financial prudence and applies a sinking fund, such amounts are not allowed as a charge in the taxation return, and, as the loss on realization on maturity cannot be claimed for tax relief, the increased loss due to the absence of a sinking fund would be of no avail.

OTHER RECEIPTS (ACCOUNTS TO BE SPECIFIED)

Under this heading are such items as—

Assignment Fees. These are the fees paid to a company for registering in its books as beneficial owner of a policy a person other than the assured, the latter having executed a deed conveying the ownership of the policy to that other person. The Assignment Fees Account is compiled from entries appearing in the Cash Book and the branch accounts. The account is closed by a Journal entry transferring the balance to the Revenue Account.

Fines. When an assured is temporarily unable to pay the premium on his policy by the time the days of grace have expired, the com-

pany generally extends the days of grace on payment of a fine, and the total of these fines is the figure included under this heading. Should the policy become a claim during this extended period the outstanding premium is deducted from the amount of the claim before payment is made. So far as the accounting is concerned the same remarks apply as in the case of "Assignment Fees."

Turning to the right-hand or (Outgo) side of the account the items in order are—

CLAIMS UNDER POLICIES PAID AND OUTSTANDING

As exemplified in Chapter IV, the Claims Account in the General Ledger includes both the paid and outstanding claims, and unless a Reassurance Claims Account is functioning, the balance of the Claims Account will be the amount set against this caption. If a Reassurance Claims Account has been established, the balance thereof will be transferred to Claims Account before the latter is closed by a transfer to Revenue Account. Remarks similar to those mentioned under "Premiums," regarding the method of arriving at the figures "Within the United Kingdom" and "Outside the United Kingdom" apply to this account and all other expenditure accounts where it is necessary to divide the items. The claims are subdivided to show those arising "By death" and those "By maturity," the latter referring to endowment assurances which have run their course owing to the assured having attained the specified age. This division is accomplished either by analysis or by maintaining separate accounts for "Claims by death" and "Claims by maturity." The claims figure includes any reversionary or other bonuses payable on policies which have become claims during the year. When a half-premium debt policy becomes a claim, the cash payment in settlement is less than the full amount insured, to the extent of the proportions of the premiums accumulated as a loan. The cash payment is posted to the debit of Claims Account and a Journal entry made debiting Claims Account and crediting Half Premium Debt Account with the total of the proportions of the premiums unpaid, so that the Claims Account is charged with the total sum insured under the policy and the Half Premium Debt Account is reduced by the amount of the debt applicable to the policy in question. Similarly in the case of a policy

which has been mortgaged to the company as security for a loan, becoming a claim, the actual cash paid to the policy-holder, or his personal representative is the sum assured after deducting therefrom the amount of the loan and any interest outstanding. The cash is posted to the debit of Claims Account and a Journal entry created debiting Claims Account with the total amount of the loan and the outstanding interest and crediting Loans on Life Policies Capital Account with the amount of the loan and Loans on Life Policies Revenue Account, with the outstanding interest.

SURRENDERS, INCLUDING SURRENDERS OF BONUS

The amounts paid to policy-holders who have discontinued the contract of assurance and surrendered their policies appear under this heading. If any bonuses have been added to the policy during the time it has been in force, the settlement made with the policy-holder will include the surrender value of such bonuses. The Life Surrender Account, which comprehends both classes of surrenders, is closed by a Journal entry transferring the balance to the Revenue Account. Where a policy on which a loan has been granted is surrendered, a similar procedure is followed to that described in the preceding paragraph.

ANNUITIES

Prior to paying an annuity, a company requires the annuitant to furnish a certificate of existence. In the event of an annuity falling due for payment towards the close of the year and the certificate of existence not having been received by the company in time to permit the cash to be paid before closing the books for the year, provision will have to be made for such unpaid annuities, as the total annuity payments falling due in the year appear under this heading. The unpaid annuities are shown in the Balance Sheet as a liability as "Annuities due and unpaid." Unless the annuitant has lodged with the company a certificate of exemption, income tax at the standard rate will be deducted from the gross amount of the annuity before making payment. A certificate of exemption is a statement, signed by the annuitant, to the effect that the annuitant's total income is less than that which is liable to assessment under the Income Tax or Finance Acts governing the year. An annuitant

whose total income is liable only to the lower rate of tax, has tax deducted at that lower rate from the gross annuity, provided the necessary income tax certificate is completed. The net annuity payments are posted from the Cash Book to the debit of Annuity Account and a Journal entry is made debiting the total tax deducted from the annuity payments to Annuity Account and crediting Income Tax deducted from Annuity Payments Account. After debiting Annuity Account with any annuities due and unpaid, the total of this account, which will then comprise the gross amount of annuity payments made and to be made in the year, is closed by transferring the balance to the Revenue Account.

BONUSES IN CASH

When a company, after its valuation, declares the bonus it is paying on its life policies, the policy-holder has the option of (a) allowing the bonus to be added to the sum assured, (b) receiving an immediate cash payment, which is the present value of the bonus, or (c) applying the bonus to the reduction of future premiums. The total of the cash payments under (b) constitutes this item in the Revenue Account and naturally is always considerably larger in the year following the company's quinquennial valuation.

BONUSES IN REDUCTION OF PREMIUMS

Should the policy-holder decide to apply the bonus to reduce the future premiums on his policy, the renewal records are amended accordingly, so that, subsequently, only the reduced premium percolates to the Premium Account. A record is maintained showing the original premiums side by side with the reduced premiums and, at the end of the year, the difference between the totals of these two groups of premiums, which is the aggregate amount of the bonuses applied in reduction of premiums, is credited by a Journal entry to Premium Account and debited to Bonuses in Reduction of Premiums Account. The latter account is closed by a transfer to Revenue Account.

COMMISSION

This is the balance of Commission Account after crediting that account with the balance of the Reassurance Commission Account.

Unless the company issues a separate revenue account for annuity business the commission payable on "Considerations for annuities granted" will also be included under this caption. Usually a higher rate of commission is allowed on initial premiums than on renewal premiums, so that in making any comparison due regard must be taken of the amount both of new business and of single premium business.

EXPENSES OF MANAGEMENT

All expenditure incidental to the carrying on, developing or extending the company's life and annuity business which has been charged definitely to these departments is included in this item together with a proportion of those expenses which, owing to their general character, have to be apportioned, and an adjusting entry made in the case of those companies which utilize the tax recoverable under Section 33, to reduce their expenses of management. Some composite companies, recognizing the impracticability of equitably allocating certain expenses, do not attempt any apportionment but limit their life and annuity expenses to a percentage of the premium income. The definite life and annuity expenses are carried direct to the Expenses of Management Account, but all the indeterminable expenses are kept in a separate account from which such an amount is transferred at the end of the period to the debit of Expenses of Management Account as will bring the total life and annuity expenses of management up to the requisite percentage. The account is closed by transferring the balance to Revenue Account. Note 4 at the foot of the Revenue Account states that if any sum has been deducted from the Expenses of Management Account and taken credit for in the Balance Sheet as an asset, the sum so deducted must be shown separately in the account. As the entry crediting expenses of management and debiting a suspense account is made before the balance of the Expenses of Management Account is transferred, to show such sums separately in the Revenue Account it is necessary to make an additional entry increasing the expenses of management by the amount taken credit for and showing this latter amount either as a reduction from the expenses of management—extending the net amount into the accounting column—or as a separate item on the opposite side of the account. The

types of expenses to which this note applies are (a) expenses paid in advance, that is, the period which they cover not having elapsed at the time the books are closed, (b) preliminary expenses incurred on the formation of the company, and (c) exceptional revenue expenditure which it is anticipated will benefit future years and which it is decided to spread over a period of years.

Note 4 is only of academic interest nowadays for the following reasons—

(1) As stated in Chapter IV, generally speaking, insurance companies do not take credit for the unexpired portion of expenses paid in advance.

(2) The incorporation of a new insurance company amenable to the Assurance Companies Act of 1909 is a very rare event nowadays.

(3) Indicative of the strong financial position of the majority of insurance companies, any exceptional revenue expenditure is usually taken care of in the accounts for the year in which it is incurred.

The same note appears at the foot of all the revenue accounts.

OTHER PAYMENTS (ACCOUNTS TO BE SPECIFIED)

Medical fees incurred in connexion with the medical examination of lives to be assured, and the Revenue Stamps on the policies, are sometimes shown as separate expenses instead of forming part of the expenses of management, in which circumstances they come under this Section. If the company transacts only life business, the dividends to shareholders are shown under this heading as also are any losses on realization of investments and income tax on profits (where the company is assessed on a profits basis and not on the basis of its interest earnings).

AMOUNT OF LIFE ASSURANCE FUND AT THE END OF THE YEAR, AS PER THIRD SCHEDULE

After giving effect to all the foregoing transfers, and provided the accounts under consideration are not in respect of a valuation year, the balance of the Revenue Account is the amount of the life assurance fund which is shown in the Balance Sheet or Third Schedule as it is called. However, when the year is a valuation one, there are additional items in the account indicating how any surplus is being disposed of, before the fund at the end of the

year is shown. It will be noticed that no mention has been made of any profit on the life and annuity business and this is due to the fact that without an actuarial valuation it is impossible to arrive at the profit or loss on the life business.

To determine the solvency or otherwise of a life fund the actuary has to value the liabilities of the fund, and the Fourth Schedule to the Assurance Companies Act, 1909, sets out the form in which the actuary's valuation must be submitted, which may be summarized as follows—

- (i) The period covered.
- (ii) The general principles adopted, including the method by which the valuation premium has been arrived at.
- (iii) The mortality tables used.
- (iv) The rate of interest assumed.
- (v) The proportion of annual premium reserved for expenses (and bonuses).
- (vi) A Consolidated Revenue Account for the period covered in the form prescribed. When an annual valuation is made, this is not required.
- (vii) Summarized details of the valuation in the form prescribed, together with a Valuation Balance Sheet.
- (viii) The principles followed in fixing the rate of bonus, and the period elapsing before a bonus (a) is allotted and (b) vests.
- (ix) Valuation results showing how the profit is allocated, with specimen bonuses.

The net liability of the life business is found by deducting the present value of the total future premiums receivable on all life policies from the present value of the total liability on all those policies.

The Consolidated Revenue Account, referred to in No. (vi), is merely a copy of First Schedule (A), but, in the case of a quinquennial valuation, it includes the aggregate amounts under each item for the previous five years.

The Summary and Valuation Form, referred to in No. (vii), is shown on the next page.

The last column headed "Net Liability" is the amount the company must retain to meet its obligations, and is arrived at by deducting the total of the column "Net Yearly Premiums" from the total "Sums Assured and Bonuses" under the heading "Valuation."

The Valuation Balance Sheet referred to in No. (vii) is shown below—

(FORM referred to under Heading No. 7 in Fourth Schedule (A))

VALUATION BALANCE SHEET of		as at	19
<i>Dr.</i>	£	<i>Cr.</i>	£
To net liability under Life Assurance and Annuity transactions (as per summary statement provided in Fourth Schedule (A))		By Life Assurance and Annuity funds (as per balance sheet under Schedule 3)	
To surplus, if any		By deficiency, if any	

Although termed a Balance Sheet, the form, as such, violates two of the rules of modern book-keeping inasmuch as the prefixes "Dr." and "Cr." are printed at the head and each item is preceded by either "To" or "By." On the debit side is the Net Liability of the fund which has been explained above, while on the credit side is entered the amount of the Life and Annuity Funds as shown in the Balance Sheet or Third Schedule; the difference, either a surplus or a deficiency, is inserted to balance the account. Where a surplus is disclosed, the disposal of it will be subject to the company's constitution, which governs the proportion of the divisible surplus to be allotted to the policy-holders and the shareholders.

Where a company transacts life business only, the amount of the surplus payable to the shareholders is shown on the expenditure side of the Revenue Account, but where the valuation is a quinquennial one, the surplus is spread over the ensuing five years, one-fifth being shown each year in the Revenue Account. The practice differs amongst composite companies having a valuation once every five years; some take credit in their Profit and Loss Account in the first year for the full amount of the shareholders' portion of the surplus, others transfer the total of the shareholders' proportion of the surplus to an intermediate account and take an amount therefrom to the credit of the Profit and Loss Account for each of the five years.

BRITISH COMPANIES TRANSACTING LIFE BUSINESS IN THE IRISH FREE STATE

Conforming to the programme laid down, it is meet now to focus attention on those British companies whose branches in the Irish Free State write life business.

The Irish Act of 1936 imposes on companies transacting life business more onerous demands than the Act of 1909, and of these the most important are the segregating of the assets of the life fund, the preclusion from carrying on any other classes of assurance business and the furnishing of certain additional information. Thus it is evident that the only assurance business such companies will be permitted to write in the Irish Free State will be life and that all the assets of the branches in the Irish Free State, i.e. agents' balances, outstanding premiums, bank balances, cash in hand, etc., will constitute part of the assets of the life fund. As a corollary it follows that any investments acquired out of the proceeds of the operations of the Irish business will be hypothecated to the life fund, while the interest accruing from such investments will be carried to the credit of the same fund. Section 98 (2) of the Irish Free State Insurance Act, 1936, promulgates the additional information required, which consists of a return of the amounts debited and credited for re-assurance in respect of Irish Free State business, showing premiums, sums assured and claims by death or maturity and by surrenders. To supply readily this data it would be advantageous to maintain separate accounts for "Reassurance Premiums" and "Reassurance Claims" rather than to carry these items direct to the debit and credit of the "Premiums" and "Claims" accounts respectively. From the preceding remarks and the obligation to set forth in the Revenue Account the further particulars detailed in Section 100 of the 1936 Act, it is obvious that whenever the Act comes into force it will be incumbent on such companies to create separate control accounts in the Head Office General Ledger for premiums, re-assurance premiums, claims, re-assurance claims, commission, expenses of management, other income and other expenditure, all in respect of Irish Free State life business, and also an account for those expenses incurred outside the Irish Free State attributable to business in the Irish Free State. In addition, accounts will have to be set up for Irish Free State investment capital, investment revenue, interest,

income tax on interest, and the Irish Free State Life Reserve Fund.

The Revenue Account to be submitted will have to show the whole of the life business transacted by the company showing separately that within the Irish Free State and that outside the Irish Free State.

Should the Minister of Industry and Commerce exercise the powers conferred upon him by Section 97 of the Act, the returns made by a company under the Assurance Companies Act, 1909, would be accepted in lieu of those required by the Irish Free State Acts.

FIRE BUSINESS

The form on the next page is that in which the fire business has to be reported and is designated First Schedule—Form (B).

The fire business to be included in this account is the total world-wide business transacted by the company, and consequently there is no necessity for companies having a branch in the Irish Free State to prepare a separate account for Irish Free State business, but the passing of the Irish Free State Insurance Act, 1936, somewhat qualifies this assertion and the remarks under the heading "British Companies transacting fire business in the Irish Free State" should be noted.

AMOUNT OF FIRE INSURANCE FUND AT THE BEGINNING OF THE YEAR

The opening item on the left-hand side of the account consists of two items (a) Reserve for unexpired risks, and (b) Additional reserve. The majority of the leading companies adopt 40 per cent of the premium income as the reserve for unexpired risks. Theoretically this figure of 40 per cent is substantiated as follows—

Assuming a company's year ends on the 31st December and it has a premium income of £100,000 each quarter, at the end of the year the amount of the unexpired premiums would be—

For Lady Day quarter approximately 3 months unexpired	£25,000
„ Midsummer quarter approximately 6 months unexpired	50,000
„ Michaelmas quarter approximately 9 months unexpired	75,000
„ Christmas quarter approximately 12 months unexpired	100,000
Making the total unexpired at the end of the year	<u>£250,000</u>

which amount is equivalent to 62½ per cent of the total premiums for the year. It is generally reckoned that the commission and

(B) FORM APPLICABLE TO FIRE INSURANCE BUSINESS

Revenue Account of the	... for the Year ending	19	in respect of Fire Insurance Business
Amount of fire insurance fund at the beginning of the year—	£ s. d.	£ s. d.	Claims under policies paid and outstanding
Reserve for unexpired risks	£ s. d.	£ s. d.	Commission
Additional reserve (if any)	£ s. d.	£ s. d.	Expenses of management
Premiums	£ s. d.	£ s. d.	Contributions to fire brigades
Interest, dividends, and rents	£ s. d.	£ s. d.	Other payments (accounts to be specified)
Less income tax thereon	£ s. d.	£ s. d.	Amount of fire insurance fund at the end of the year as per Third Schedule—
Other receipts (accounts to be specified)	£ s. d.	£ s. d.	Reserve for unexpired risks being per cent of premium income for the year
	£ s. d.	£ s. d.	Additional Reserve (if any)
	£ s. d.	£ s. d.	

NOTE 1. Items in this Account to be the net amounts after deduction of the amounts paid and received in respect of reinsurances of the Company's risks.

NOTE 2. If any sum has been deducted from the Expenses of Management Account, and taken credit for in the Balance Sheet as an asset, the sum so deducted to be separately shown in the above Account

working expenses represent approximately one-third of the premium income, and as the charges for both these will have been made already, it is only necessary to create a reserve for the remaining two-thirds of the 62½ per cent, which, for all practical purposes, is 40 per cent. This reserve of 40 per cent would be quite adequate for home business where the premiums include a good deal of short-period business for six months and less and time on risk policies which would have run off to a greater extent than the annual business, but where a company's figures include United States business the ordinary reserve of 40 per cent is insufficient owing to the prevalency in the U.S.A. of long term business running for a matter of four or five years.

The New York State Insurance Law requires companies to state in their annual returns the amount of their premiums under one-, two-, three-, four-, and five-year contracts and to reserve definite proportions of such premiums for unexpired risks. Thus, on a one-year contract a reserve of one-half of the premium is necessary and on longer contracts a reserve calculated *pro rata* from the date of issue of the policy, reckoning all policies from the middle of the first year. For example, the reserve at the end of 1936, on a four-year policy taken out in 1934, would be three-eighths of the premium, that is, one and a half years' unexpired period divided by the term of the policy, viz. four years. From the foregoing it will be seen that the ratio which the reserve bears to the premium income depends upon the proportion of long term business in the company's portfolio. Further, it may be noted that this legal reserve is in excess of what would be required to reinsure the outstanding risks, as in the latter event the company would be relieved of ordinary expenses of management and commission, which costs will have been debited already in the year's accounts, so that the legal reserve should be reduced by an equivalent amount, which is taken to be approximately one-third. Similarly the legal reserve for Canadian business varies with the amount of long-term business.

During the last few years the average legal reserve for U.S.A. and Canadian branches of British companies has been in the neighbourhood of 100 per cent and 72 per cent of the premium income respectively, and reducing these figures by one-third for expenses of management and commission, which have been debited already,

gives 66 per cent and 48 per cent as the true reserve for the unexpired liability. Consequently, where a company operates to any large extent in the U.S.A. and/or Canada, it should provide something in addition to the usual 40 per cent reserve. The larger companies have built up their additional reserves to such an extent that, at present, their total reserve for unexpired risks equals 100 per cent or more of their premium income. Unless investments are hypothecated to the Fire Funds there seems to be no advantage in increasing this reserve beyond its absolute requirements, as a large general reserve available to all sections of business would serve the same purpose, and in addition, could be employed for other purposes if so required.

FIRE PREMIUMS

This is the balance of the Fire Premium Account after transferring to that account the balance of the Reinsurance Premiums Account. The Fire Premium Account is closed by a Journal entry transferring the balance to Fire Revenue Account. There is no need to analyse the premiums or to have separate accounts for premiums appertaining to different countries, as is necessary in the Life business.

INTEREST, DIVIDENDS AND RENTS, LESS INCOME TAX THEREON

As the form laid down in the Act for the Profit and Loss Account includes an item "Interest and dividends not carried to other accounts," some companies have interpreted this to mean that it is not obligatory to show interest in any of the Revenue Accounts other than the Life and Annuity Account. Suffice it for the present to say that those companies which include interest in all their Revenue Accounts, without segregating their investments, usually compute the amount applicable to the different funds by apportioning the total interest and the tax thereon *pro rata* to the mean funds, and in such cases the interest in the Fire Revenue Account is the amount calculated on the mean fire fund. Naturally, where the fund is represented by specific investments the interest from such investments will be the amount included in the revenue account.

TRANSFERS FROM PROFIT AND LOSS ACCOUNT

The only other items which it is customary to find on the income side of the Fire Revenue Account are transfers from the Profit and Loss Account. Such transfers may be due to an underwriting loss arising in the year, or the company may desire to increase its additional reserve. If, unfortunately, the company has suffered an underwriting loss an equivalent amount is transferred from the Profit and Loss Account to the credit of the Revenue Account in order to balance this account. If the company is desirous of increasing its additional reserve there are two courses open to it, either it may transfer from the Profit and Loss Account the amount by which it desires to increase the additional reserve and transfer to the Profit and Loss Account the whole of the profit for the year, or, alternatively, it may reduce the amount of the profit to be transferred to the Profit and Loss Account by the amount of the increase in the additional reserve. The net effect on the Revenue and Profit and Loss Accounts is the same whichever method is adopted, but the difference in treatment results in the additional reserve being augmented out of the current year's fire profits in the latter case, while in the former case the increase is built up from profits generally.

On the expenditure side of the account, the "Claims under policies paid and outstanding," "Commission" and "Expenses of Management" are obtained in a like manner to that described for the Life Account.

CONTRIBUTIONS TO FIRE BRIGADES

This item is peculiar to the Fire Revenue Account and includes charges levied upon the company by both the Metropolitan Fire Brigade and provincial fire brigades and in some cases foreign fire brigades as well. It is of interest to note that the Insurance Undertakings Bill provides for these contributions being included with the fire claims.

OTHER PAYMENTS (ACCOUNTS TO BE SPECIFIED)

There is a lack of uniformity amongst the companies in their method of showing Dominion and foreign taxes. The various practices are (a) to show as separate items in the appropriate Revenue

Accounts the Dominion and foreign taxes applicable to the different section of business; (b) to show the whole of these taxes in one item in the Profit and Loss Account; and (c) not to disclose such taxes, but to include the total of them with the expenses of management. The present insistent demand for more informative accounts and the fact that these taxes are uncontrollable expenses are two cogent reasons for divorcing them from the ordinary expenses of management and adopting either the first or the second procedure above stated. The first method would seem to be justified where the tax can be applied definitely to any one section of the business, which would be the position where only one class of business was transacted in the territory levying the tax or where the tax was assessed on the premium income and it could be divided readily among the component sections of business. Where the tax is charged on the whole of the composite underwriting profits of the territory then the debiting of this item in the Profit and Loss Account would appear to be more equitable.

BAD DEBTS

The practice of dealing with bad debts is similarly diverse. In some cases they are analysed into their constituent parts and shown as separate items in the relevant Revenue Accounts and, as a corollary, any recoveries on account of bad debts previously written off included as a separate item on the income side of the Revenue Account. In other cases, any recoveries are deducted from the bad debts and the net amount only shown in the Revenue Account as a distinct item. Some companies deal with bad debts and recoveries in connexion therewith in the Profit and Loss Account, irrespective of the class of business to which they refer, while others refrain from divulging such items and charge the net amounts either to their expenses of management or against their premium income.

PROFITS REALIZED

British companies do not vary from year to year the percentage of premium income for the reserve for unexpired risks, and as the additional reserve is generally more than sufficient to take care of the unexpired portion of the U.S.A. and Canadian business, any change in the actual amount of the unexpired premiums is reckoned

to be provided for by the automatic increase or decrease in the percentage reserve. Assuming a company worked on a reserve for unexpired risk of 40 per cent of its premium income, the entries in its books would be dealt with by one of the following methods—

Under the first method both a Fire Revenue Account and a Fire Reserve Fund Account function. At the beginning of the year the Fire Reserve Fund Account will show a credit balance brought down from the previous year consisting of the 40 per cent of the previous year's premiums together with the amount of the additional reserve. A Journal entry is made debiting the Fire Reserve Fund Account with this amount and crediting the Fire Revenue Account. At the end of the year the Premiums, Claims, Commission, and Expenses of Management, etc., Accounts are closed and the balances transferred by Journal entry to the Fire Revenue Account in the manner indicated above. A calculation is made to arrive at 40 per cent of the premiums for the current year and this amount, together with the amount of the additional reserve—provided no change is made in the additional reserve—is journalized to the debit of Fire Revenue Account and the credit of Fire Reserve Fund Account. The balance on the Fire Revenue Account represents a profit or a loss which is transferred to or from the Profit and Loss Account as the case may be, while the Fire Reserve Fund Account shows a credit balance which is included in the Balance Sheet as a liability.

The second method combines the two accounts under the appellation Fire Revenue and Reserve Account and the balance of this account at the beginning of the year is the reserve for unexpired risks carried forward from the preceding year. The various revenue items are transferred thereto by Journal entry as previously indicated, and at the end of the year the account is debited with the total of both the 40 per cent of the current year's premiums and any additional reserve. This 40 per cent and any additional reserve are then brought down as a credit to the following year, while the underwriting profit or loss is cared for in the manner already noted.

BRITISH COMPANIES TRANSACTING FIRE BUSINESS IN THE IRISH FREE STATE

Whenever the Minister of Industry and Commerce decrees that Part VII of the Irish Free State Insurance Act, 1936, shall come into

operation, any British company transacting fire business in the Irish Free State and deciding to continue to do so will have to deposit £20,000 in accordance with Section 22 of the Act, and will be subject to the regulations contained in Sections 98 and 100. Section 98 enacts that within six months of the end of the accounting year companies shall furnish a return showing the amounts of Irish Free State premiums and claims which have been reinsured and also the amounts of Irish Free State premiums and claims which have been accepted by way of reinsurance, and Section 100 calls for further particulars in the Revenue Account. While this information might be available quite readily by analysis, it would appear to be more expedient to maintain separate accounts in a similar manner to that already outlined in the case of British companies transacting life business in the Irish Free State, but insofar as the fire business is relieved by Section 105 (5) from keeping its assets separate, the legal position would be unimpeachable by the omission to create individual control accounts in the Head Office Ledger for investment capital, investment revenue, interest, and tax on interest in respect of the Irish Free State fire business.

When Part VII of the Act becomes operative the Revenue Account for fire business, instead of reflecting the world-wide operations in totals, as at present, will have to show the Irish Free State business separately from the remainder of the business, unless exemption is granted to the company by the Minister of Industry and Commerce under Section 97 of the 1936 Act.

PERSONAL ACCIDENT BUSINESS

The form in which the Revenue Account for this class of business has to be submitted is shown in the First Schedule (C) and is as shown on the next page.

Neither the United Kingdom nor the Irish Free State Authorities—the latter until such time as the functioning of the Irish Free State Insurance Act, 1936, intervenes—call for the personal accident business emanating from their individual territories to be shown separately, consequently the total world-wide business of this class transacted by the company is included in this account. The form of Revenue Account prescribed differs in two essentials from that laid down for fire business. Firstly, the amount of the fund, both

(C) FORM APPLICABLE TO ACCIDENT INSURANCE BUSINESS

Revenue Account of the ... for the Year ending ... 19 ... in respect of Accident Insurance Business

£ s. d.	£ s. d.	£ s. d.
<p>Amount of accident insurance fund at the beginning of the year— Reserve for unexpired risks Total estimated liability in respect of outstanding claims Additional reserve (if any)</p>	<p>Payments under policies, including medical and legal expenses in connexion therewith Commission Expenses of management Other payments (accounts to be specified)</p>	<p>Amount of accident insurance fund at the end of the year as per Third Schedule— Reserve for unexpired risks being per cent of premium income for the year Total estimated liability in respect of outstanding claims as per Fourth Schedule (C) Additional reserve (if any)</p>
<p>Premiums Interest, dividends, and rents Less income tax thereon</p>		
Other receipts (accounts to be specified)		
		£

NOTE 1. Items in this Account to be the net amounts after deduction of the amounts paid and received in respect of reinsurance of the Company's risks.

NOTE 2. If any sum has been deducted from the Expenses of Management Account, and taken credit for in the Balance Sheet as an asset, the sum so deducted to be separately shown in the above Account.

at the beginning and at the end of the year, consists of three parts instead of two as provided for in the Fire Account, the additional one, which is self-explanatory, being the "Total estimated liability in respect of outstanding claims." Secondly, ensuing from the inclusion of the outstanding claims in the fund, the claims shown in the account are paid claims only, as distinct from incurred claims in the Fire and Life Revenue Accounts. The incurred claims for the year can be compiled by abstracting the outstanding claims from the funds at the beginning and at the end of the year and adding the latter to the paid claims and subtracting the former. All personal accident claims figures include medical and legal expenses in connexion therewith.

This special mode of exhibiting the outstanding claims applies to both personal accident and employers' liability business and, naturally, requires different treatment in the books of the company from that followed in the case of life and fire outstanding claims. Instead of debiting the outstanding claims to the current year's Claims Payments Account and bringing them down as a credit to the following year, the Claims Accounts for personal accident and employers' liability business contain payments only, which payments include medical and legal expenses paid in connexion with the claims. The Claims Account is closed by transferring the balance, by Journal entry, to Personal Accident Revenue Account or Employers' Liability Revenue Account, as the case may be, and appears as the opening item on the expenditure side of the Revenue Account, viz. "Payments under policies, including medical and legal expenses in connexion therewith." The provision for outstanding claims is created by a Journal entry debiting Personal Accident Revenue or Employers' Liability Revenue Account, according to the class of business concerned, and crediting the corresponding Reserve Fund Account, but where the Revenue and Reserve Fund Accounts are amalgamated, the provision is made by debiting the Revenue and Reserve Fund Account and bringing down the item, as a liability, in conjunction with the 40 per cent reserve and any additional reserve.

Payments for injuries and incapacity arising out of claims under personal accident policies often extend for years before the claims are finally settled and, with a view to testing the adequacy of the

reserves set up for such claims, a form set out in the Fourth Schedule (C) has to be completed annually. In this form the outstanding claims are summarized and compared with the total estimated liability for outstanding claims as shown in the Revenue Account. Particulars of amounts actually paid are shown side by side with the estimates of previous years, and the claims divided between fatal and non-fatal, the non-fatal claims being further subdivided into those involving payment of sums insured, those involving payment of temporary weekly allowances and those involving payment of yearly allowances during permanent total disablement.

BRITISH COMPANIES TRANSACTING PERSONAL ACCIDENT BUSINESS IN THE IRISH FREE STATE

Immediately the Irish Free State Insurance Act, 1936, operates, any British company writing personal accident business in the Irish Free State and desiring to continue to write such business will be called upon to deposit £20,000 unless a deposit has already been made in connexion with any of the following classes of business, viz. fire, employers' liability, public liability, engineering, guarantee or burglary. Remarks similar to those appearing in connexion with British companies transacting fire business in the Irish Free State apply equally in the present circumstances.

EMPLOYERS' LIABILITY BUSINESS

The manner in which the Revenue Account for this class of business has to be returned is given in the First Schedule (D) and is as on the next page.

In 1923, the Accident Offices Association, on behalf of its members, entered into an agreement with the Home Office for the purpose of limiting the charges to employers in respect of employers' liability insurance. The substance of the agreement was that if the aggregate claims experience of all the offices concerned was less than 60 per cent for the years 1924, 1925, and 1926 and, subsequently, less than $62\frac{1}{2}$ per cent, or such other proportion (not being less than 60 per cent) as agreed between the Secretary of State and the Accident Offices Association, the difference would be returned by the offices to the employers in the following year in the form of a

(D) FORM APPLICABLE TO EMPLOYERS' LIABILITY INSURANCE BUSINESS

Revenue Account of the..... for the Year ending19 in respect of Employers' Liability Insurance
Business transacted within the United Kingdom

£ s. d.	£ s. d.	£ s. d.
<p>Amount of employers' liability insurance fund at the beginning of the year— Reserve for unexpired risks . Total estimated liability in respect of outstanding claims Additional reserve (if any) .</p> <p>Premiums Interests, dividends, and rents . Less income tax thereon .</p> <p>Other receipts (accounts to be specified) .</p>	<p>Payments under policies, including medical and legal expenses in connexion therewith Commission Expenses of management Other payments (accounts to be specified)</p> <p>Amount of employers' liability insurance fund at the end of the year, as per Third Schedule— Reserved for unexpired risks, being per cent of premium income for the year. Total estimated liability in respect of outstanding claims, as per Fourth Schedule (D) Additional reserve (if any) .</p>	£ s. d.
£	£	£

NOTE 1. Items in this Account to be the net amounts after deduction of the amounts paid and received in respect of reinsurance of the Company's risks.

NOTE 2. If any sum has been deducted from the Expenses of Management Account, and taken credit for in the Balance Sheet as an asset, the sum so deducted to be separately shown in the above Account.

rebate of premium. Thus, out of the remaining 40 per cent or so the offices were prepared to pay commission and expenses and endeavour to make a profit, and should the combined claims experience of all the offices be less than the stipulated percentage, an individual office would be bound to return the agreed rate of rebate to the employers insured with it, notwithstanding its own claims ratio was in excess of such percentage. Any adjustment made as a result of this agreement is not taken into account when computing the overall claims experience in the following year.

This form of Revenue Account is identical with that for accident business, except for the obvious alteration in the designatory letter of the summary containing the estimated liability in respect of outstanding claims under the Fourth Schedule. The details of the claims paid and outstanding have to be furnished in the form set out in the Fourth Schedule (D), and the statement respecting claims of five years' duration and upwards outstanding as at the end of the year of account has to be made and signed by an actuary.

In this account business transacted within the United Kingdom only is included.

As companies operating in the Irish Free State come within the purview of the Irish Free State Assurance Companies Act, 1909, Adaptation Order, 1928, they have to prepare a Revenue Account for employers' liability business transacted within that country and also a summary of Irish Free State claims paid and outstanding, similar in form to that of the United Kingdom Schedule, so that the application of the Irish Free State Insurance Act, 1936, will not materially affect them. The various Ledger accounts, the balances of which are transferred to the Employers' Liability Revenue Account for both the United Kingdom and the Irish Free State, may be kept separately under these two categories or, alternatively, the information may be obtained from total accounts by analysis. Section 4 of the Isle of Man Workmen's Compensation Act of 1927 calls for statements regarding employers' liability business transacted within the Isle of Man to be furnished to the Isle of Man authorities. So far as the actual accounting in the books of the company is concerned, the remarks under the heading of "Personal Accident Business" will apply subject to the alterations in the names of the accounts.

The commission payable in respect of employers' liability business is less than that ordinarily payable on accident business, the reduction following the agreement between the Accident Offices Association and H.M. Home Office.

BRITISH COMPANIES TRANSACTING EMPLOYERS' LIABILITY BUSINESS IN THE IRISH FREE STATE

The innovations embodied in the Irish Free State Insurance Act, 1936, will not cause any radical changes in the recording of employers' liability insurance, as the companies now doing this class of business in the Irish Free State are obliged to render a Revenue Account for such business. The only additional information they will have to supply will be the amounts of Irish Free State inwards and outwards reinsurances—both premiums and claims—and the employers' liability outstanding premiums. To fulfil the latter obligation, companies transacting other classes of insurance as well as employers' liability will either keep separate agents' accounts for this class of business or analyse all agents' balances at the end of the accounting period to ascertain the outstanding premiums applicable to this business. Under the existing laws, British companies include any employers' liability business outside the United Kingdom and the Irish Free State with their general accident or miscellaneous business, but whenever the Irish Free State Insurance Act, 1936, becomes operative, such business will be incorporated in the employers' liability Revenue Account under the heading "Business outside the Irish Free State."

The remarks made under "Personal Accident Business" regarding deposits apply to this class of business with the substitution of "employers' liability" for "personal accident" business.

BOND INVESTMENT BUSINESS

The Revenue Account for this business is set out in the First Schedule (E) and is as shown on the next page.

This account needs no special comment, the items being similar to those discussed when dealing with the other Revenue Accounts. As Sections 5 and 6 apply to bond investment business, at least once in every five years statements in the forms set out in the Fourth Schedule (E) and Fifth Schedule (E) must be prepared.

(E) FORM APPLICABLE TO BOND INVESTMENT BUSINESS

Revenue Account of the for the Year ending 19 .. in respect of Bond Investment and Endowment Certificate Business

	<p>£ s. d.</p> <p>Amount of Bond Investment and Endowment Certificate Fund at the beginning of the year</p> <p>Additional reserve (if any)</p>	<p>£ s. d.</p>	<p>Claims under bonds and certificates, paid and outstanding</p> <p>Commission</p> <p>Expenses of management</p> <p>Other payments (accounts to be specified)</p>	<p>£ s. d.</p>
<p>Premiums</p> <p>Interest, dividends, and rents</p> <p>Less income tax thereon</p>	<p>£ s. d.</p>		<p>Amount of Bond Investment and Endowment Certificate Fund at the end of the year as per Third Schedule</p> <p>Additional reserve (if any)</p>	<p>£ s. d.</p>
<p>Other receipts (accounts to be specified)</p>				<p>£</p>

NOTE 1. Items in this Account to be the net amounts after deduction of the amounts paid and received in respect of reinsurance of the Company's risks.

NOTE 2. If any sum has been deducted from the Expenses of Management Account, and taken credit for in the Balance Sheet as an asset, the sum so deducted to be separately shown in the above Account.

BRITISH COMPANIES TRANSACTING BOND INVESTMENT BUSINESS IN THE IRISH FREE STATE

As Section 7 of the Irish Free State Insurance Act, 1936, repeals paragraphs (b) and (c) of Section 34 of the Assurance Companies Act, 1909, the coming into operation of the former Act will occasion the establishment of a deposit of £20,000 for bond investment business unless a deposit for the same amount has already been made for another class of business other than life and industrial assurance business. Subject to the Minister of Industry and Commerce not exercising the power imparted to him by Section 97 (viz. to accept, in lieu of the accounts, etc., called for by the Act, those submitted to a company's own government) the presentation, within six months of the end of the accounting period, of a return of the amount of inwards and outwards reinsurance—both premiums and claims—will be compulsory as also will be the preparation of the supplementary material for the Revenue Account, referred to in Section 100.

The existing Acts provide for the Bond Investment Revenue Account embodying world-wide business, but Section 100 of the Irish Free State Insurance Act, 1936, makes provision for that country's business being shown distinct from the remainder.

OTHER CLASSES OF INSURANCE BUSINESS

The "N.B." to the First Schedule of the Assurance Companies Act, 1909, reads "Where marine insurance business or sinking fund or capital redemption insurance business is carried on, the income and expenditure thereof to be stated in like manner in separate accounts. Any additional businesses (including employers' liability insurance business transacted out of the United Kingdom) to be shown in a separate inclusive general account." Such additional business may be, *inter alia*, burglary, fidelity guarantee, public liability, plate glass, engineering, etc. The form of Revenue Account laid down for fire insurance is that usually adopted for presenting the general insurance business, while the revenue account for capital redemption and sinking fund business must follow the lines of the life Revenue Account and, as both these forms have already been discussed in detail, they need no further consideration.

BRITISH COMPANIES TRANSACTING PUBLIC LIABILITY, ENGINEERING, GLASS, GUARANTEE, AND BURGLARY BUSINESS IN THE IRISH FREE STATE

The Assurance Companies Act, 1909, does not specifically mention these classes of business, but the Irish Free State Insurance Act, 1936, encompasses them, so that companies writing any or all of these classes in the Irish Free State will be amenable to Section 22 of the latter Act which calls for a deposit of £20,000, but with exemption in the case of glass insurance. Section 104 of the Irish Free State Insurance Act, 1936, enacts that the Act of 1909 shall apply to a company carrying on one or more of these classes of insurance with the modifications that Section 5 (which deals with the valuation to be made and set forth in the forms prescribed in the Fourth Schedule) and Section 6 (which deals with the statement to be prepared at the time of such valuation and set forth in the forms prescribed in the Fifth Schedule) shall not apply. Section 104 also enacts that Section 32 of the 1909 Act shall apply (except paragraphs (a), (b), and (c)) with the substitution of the appropriate class of insurance for the words "accident insurance" wherever they occur. The form in which the statement of business has to be prepared annually is governed by this Section and is such as the Minister of Industry and Commerce shall from time to time direct.

MOTOR VEHICLE BUSINESS

Prior to the passing of the Road Traffic Act, 1930, motor vehicle business was included with the general insurance, but Section 42 (2) of that Act stipulated that the Assurance Companies Act, 1909, should apply to motor vehicle business in the same way as it applies to accident insurance, but Section 42 (2) (c) of the Road Traffic Act specifically excluded the following sections of the Assurance Companies Act, viz. Section 5, which requires an actuarial investigation at least once in every five years; Section 6, which requires a statement in the form set forth in the Fifth Schedule to the Act; and Section 32 (a), which requires an annual summary of the claims paid and outstanding in the form set forth in the Fourth Schedule of the Act. After the passing of the Road Traffic Act it was decided by the Board of Trade that the form of account for

accident business was not altogether suitable for motor vehicle business, and, after consultation with the Accident Offices Association, a modified form of account was adopted. The modification only affected the method of showing the outstanding claims, which, instead of being included in the funds at the beginning and the end of the year, as in the case of the Personal Accident Account, are incorporated with the paid claims, thus making the claims figure an incurred one following the method of showing claims in the Fire and Life Revenue Accounts. As a result of this Act, motor vehicle business, since 1931, has to be shown in a separate Revenue Account but no summary of claims is necessary. Incidentally, Section 42 (2) (a) of the Act makes it compulsory for insurance companies who carry on motor vehicle business to deposit £15,000, and by Section 42 (2) (b) this deposit must be made irrespective of whether any other deposit has been made or not.

The regulations governing the procedure to be adopted in making the deposit are contained in Part III of the Statutory Rules and Orders, 1933 (No. 311), dated 7th April, 1933, which may be cited as "The Motor Vehicles (Third Party Risks) Regulations, 1933." Subject to the elimination of those clauses permitting the withdrawal and the omission to make a deposit in certain circumstances and also the substitution of the Accountant-General of the Supreme Court for the Paymaster-General, the regulations follow those regarding deposits appearing in the Statutory Rules and Orders, 1910 (No. 566), commonly known as "The Board of Trade Order dated 6th June, 1910 (No. 566)." (See page 83.)

The Road Traffic Act, 1930, does not apply to Northern Ireland, but the Motor Vehicles and Road Traffic Act (Northern Ireland), 1930, provides that any company carrying on motor business in Northern Ireland must make a deposit of £15,000 with the Court in Northern Ireland, unless the business is already carried on in Great Britain and the deposit of £15,000 has been made with the Supreme Court in England.

Following the United Kingdom Act the Irish Free State passed a like Act, the Road Traffic Act, 1933, but whereas the United Kingdom Act required companies to include in their motor vehicle Revenue Account the total world-wide motor vehicle business, Section 76 (2) (d) of the Irish Act provides for the Revenue Account

showing the mechanically propelled vehicle insurance business within the Irish Free State only. Companies underwriting this class of business both in the United Kingdom and in the Irish Free State render their accounts in the manner shown on the next page, which form has had the acquiescence of both authorities.

Section 76 (2) (a) of the Irish Road Traffic Act calls for a deposit in the Irish Free State of £15,000 by any company transacting mechanically propelled vehicle insurance there, and paragraph (b) of the same section enforces this deposit notwithstanding other deposits having been made for other classes of business. Paragraphs (c) and (e) intimate that the following sections of the Assurance Companies Act, 1909, as amended by the Adaptation Act of 1922 shall not apply, viz. Section 5, 6, and 32 (a). Thus no investigation nor summary of claims is required.

Section 42 of the Isle of Man Road Traffic Act, 1933, enacted that companies transacting motor vehicle business in the Isle of Man must render an account of their Isle of Man business in a similar form to that required under the Road Traffic Act of 1930.

The various Ledger accounts whose balances are transferred to produce the Motor Vehicle Revenue Account either may be kept in total and the information necessary for the Irish Free State and the Isle of Man obtained by an analysis, or separate accounts may be created under the three headings. The method of closing the accounts and transferring the balances to the Revenue Account is identical with that adopted in the case of the Fire Revenue Account.

BRITISH COMPANIES TRANSACTING MECHANICALLY PRO- PELLED VEHICLE INSURANCE BUSINESS IN THE IRISH FREE STATE

So far as the deposit is concerned the enforcement of the Irish Free State Insurance Act, 1936, will not affect companies doing this class of business, as the same amount is required as under the Irish Free State Road Traffic Act, 1933, viz. £15,000, but the imposition of the other sections of the Act pertinent to mechanically propelled vehicle insurance will entail considerably more clerical labour on the companies' part. When the Act becomes operative, unless the Minister of Industry and Commerce uses the prerogative bestowed upon him by Section 97 of the 1936 Act, the companies

MOTOR VEHICLE INSURANCE ACCOUNT

	Business within the Irish Free State	Business out of the Irish Free State	Total		Business within the Irish Free State	Business out of the Irish Free State	Total
Amount of Motor Vehicle Insurance Funds at the beginning of the year— Reserve for unexpired risks	£ s. d.	£ s. d.	£ s. d.	Claims under policies paid and outstanding . . . Commission . . . Expenses of Management Carried to Profit and Loss Account	£ s. d.	£ s. d.	£ s. d.
Premiums				Amount of Motor Vehicle Insurance Funds at the end of the year as per Third Schedule— Reserve for unexpired risks, being 40 per cent of premium income for the year			
Loss carried to Profit and Loss Account							

NOTE. In this return the business described as "Motor Vehicle Insurance" corresponds exactly to the business described as "Mechanically Propelled Vehicle Insurance" in Section 76 (2) (d) of the Road Traffic Act, 1933, of the Irish Free State.

will have to submit a return showing the amount of inward and outward reinsurance—both premiums and claims—*vide* Section 98 and, in addition to a Revenue Account as rendered at present, to implement the British and Irish Free State Road Traffic Acts, will have to show the amount of the Irish Free State mechanically propelled vehicle premiums outstanding. This latter exaction will have to be fulfilled either by analysis or by keeping separate accounts for this class of business, as illustrated under employers' liability business. Further, Section 103 imposes upon companies an obligation to prepare annually a statement of the estimated liability in respect of Irish Free State outstanding and unsettled claims in the form set forth in the Sixth Schedule to the Act.

AIRCRAFT INSURANCE BUSINESS

The Air Navigation Act, 1936, *inter alia* introduces a scheme of compulsory insurance of aircraft against third party risks and the corresponding provisions of the Road Traffic Acts, 1930 and 1934, have been followed as closely as possible. Section 20 (1) of the Air Navigation Act, 1936, brings aircraft insurance within the scope of the Assurance Companies Act, 1909, and subsection (2) of the same Section decrees that the Assurance Companies Act, 1909, shall apply with respect to aircraft insurance business in the same way as it applies to motor vehicle insurance business, provided that the Board of Trade may direct that such alterations as they think appropriate shall be made in the forms of accounts and Balance Sheet required to be presented in accordance with Section 4 of the Assurance Companies Act, 1909. This subsection also provides that if a company carries on both aircraft insurance business and motor vehicle insurance business, paragraphs (a) and (b) of subsection (2) of Section 42 of the Road Traffic Act, 1930 (which relate to the deposit to be made under Section 2 of the Assurance Companies Act, 1909), shall have effect as if the aircraft insurance business were part of the motor vehicle insurance business.

Section 22 of the Air Navigation Act, 1936, intimates that Part III of the Act, which in addition to various other matters includes the before-mentioned section, shall come into operation on such a day as the Secretary of State may appoint.

It will be apparent from the foregoing that where a company transacts aircraft insurance business in addition to motor vehicle insurance business, the deposit of £15,000 set up for the latter will not require to be augmented on account of aircraft insurance business, but where motor vehicle insurance business is not carried on and a company commences to write aircraft insurance business, irrespective of whatever other deposits for other classes of insurance business are in force, a deposit of £15,000 will be imperative.

MARINE INSURANCE BUSINESS

Companies carrying on marine insurance solely are not subject to the provisions of the Assurance Companies Act, 1909, and usually prepare their accounts on what is known as the Underwriting basis, but those companies to which the Act applies and which transact marine business must, in accordance with the "N.B." to the First Schedule to the Act, "show the income and expenditure in a like manner in a separate account," that is, on a Revenue basis. The principal difference between these two types of presenting the results of a company's operations is that, in the former, only the items affecting the year of account are included, and consequently the amount of profit is not determined until that Underwriting Account is closed, a matter of two or three years later, while the latter reflects all transactions of the year irrespective of the period to which they relate and the profit is computed at the close of the year. The former method is the older one and the need for such a method is evident when one considers the delay which occurs in the presentation and settlement of marine claims, often a matter of years. One need only cite the not uncommon practice of holding up repairs to a vessel until the ship is laid up, where the damage by a sea peril is of minor importance and freights are remunerative. Also if a claim involves a General Average Adjustment, the collecting of the necessary information from the various parties interested in order to prepare the average statement and apportionment is often a long drawn out procedure. Thus in marine insurance the possibility of estimating, with any degree of accuracy, the outstanding liability at the end of the first year is almost impossible.

MARINE PREMIUMS AND BROKERAGE

Marine insurance business may be divided broadly into two classes, the insuring of hulls and the insuring of cargoes. Companies almost invariably receive their hull business through the medium of insurance brokers, but the insurance of cargoes is often obtained direct from the shipper or other interested party. Dealing with the business introduced by brokers, the brokers, on receiving instructions from their clients to obtain cover, prepare what is technically known as a "slip," on which is given brief particulars of the risk to be insured. The "slip" is presented to the Underwriter who indicates thereon the amount of insurance he is willing to take and the rate at which he will insure the risk. The company enters in its Risk Book the information from the "slip," also the amount it has underwritten and the rate it has quoted, and from this source, or from a copy of the "slip," the premium is calculated, the policy made out and the debit note prepared, this latter being dispatched forthwith to the broker.

The standard allowance to marine insurance brokers is 5 per cent which, in marine circles, is termed "brokerage" as distinct from the term "commission" used in other classes of insurance business. This brokerage is always deducted from the gross premium and from the resultant figure a further deduction of 10 per cent for cash discount is allowed provided the premium is paid within a stipulated time. Recently an additional allowance of $\frac{1}{2}$ per cent on hull business and $2\frac{1}{2}$ per cent on cargo business has been granted to those brokers who have signed an agreement undertaking not to pass on this extra allowance to their clients.

The debit note referred to above shows the gross premium, then the brokerage, discount and the additional allowance (which items are bracketed together and taken as 15 per cent of the gross premium in the case of hull business and one-sixth of the gross premium in the case of cargo business) and the cost of the stamp on the policy. Contrary to the custom in other branches of insurance, the cost of the stamp is borne by the insured. From the debit notes the net premium (i.e. the gross premium less the brokerage, discount and additional allowance), the cost of the stamp and the total amount due are entered into a Premium Book or Journal and from this book the ~~net~~ amount due from each broker or insured is posted

to the debit of his account in the Personal Ledger. In the General Ledger the aggregate of these amounts is posted to the debit of a control account for the Personal Ledger and the component parts, comprising the net premium and the stamp duty, are posted to the credit of Premium Account and Stamp Account respectively. The latter account will have been debited already, via the Cash Book, with the cost of stamping the policies. An alternative procedure is to post direct from the debit notes to the debit of the broker's or insured's accounts in the Personal Ledger and to summarize the debit notes each month for the General Ledger postings. Statements of account are rendered monthly to the brokers and, in theory, the policies are not handed over to the broker until settlement of the account is made. Legally a "slip," unless it is supported by a correctly stamped policy, does not constitute an insurance cover.

Renewals, as understood in other sections of insurance, are not usually met with in marine insurance and, consequently, the accounting and recording of marine transactions does not lend itself so readily to the labour-saving devices which are possible in the case of life, fire, and accident business.

RETURNS

In "Time" policies there is generally a clause providing that a proportionate part of the premium will be returned to the insured in the event of it being mutually agreed to cancel the policy, or if the vessel is laid up. The basis of the return is as follows—

1. If the policy is cancelled—

A *pro rata* return calculated on the number of days,

Or

one-twelfth the annual premium for each thirty days.

2. If the vessel is laid up—

(a) In the United Kingdom not under repair, for each consecutive thirty days one-twelfth the annual premium, less 1s. per cent.

(b) Abroad or under repair, for each consecutive thirty days one-twelfth the annual premium less 2s. 6d. per cent.

3. In the case of insurances on freight or on hulls on T.L.O. (Total Loss Only), F.P.A. Abs. (Free Particular Average Absolutely), or

F.O.D. (Free of Damage) Conditions the return in the event of the vessel being laid up in port for each consecutive thirty days is one-twelfth the annual premium less 6d. per cent.

Where the accounts are maintained on an underwriting basis, these returns are analysed so that the account for the year in which the premium was credited can be debited.

MARINE CLAIMS

From the casualties reported daily in Lloyd's Lists, those in which the company are interested are entered into a Casualty Book which is maintained for estimating purposes. Immediately a claim is presented and approved the details are entered in the Claims Register, which is ruled to accommodate the name of the broker or insured, the particulars of the claim, the underwriting year to which the claim refers, the amount of the claim and the date paid, together with any other columns required by the individual company. Each claim is credited to the broker's or insured's account concerned in the Personal Ledger and in the General Ledger the total of the claims is periodically posted to the debit of Claims Account, and to the credit of the Personal Ledger Control Account. When the cash is paid in settlement of a claim it is posted to the debit of the broker's or insured's personal account. Salvage is treated in a similar manner, a separate book being kept for salvage recoveries and the individual items being debited to the client's personal account and the periodical totals being credited and debited respectively in the General Ledger to Claims Account and the Personal Ledger Control Account. Cash received for salvage is entered in the Cash Book and posted from there to the credit of the client's account.

UNDERWRITING SYSTEM (THREE-YEAR BASIS)

Under this system all items are segregated to the year's account to which they relate; thus the premiums applicable to the current year, less any returns thereon and reinsurances in connexion therewith are shown on the income side of the account, and on the expenditure side are shown the claims paid, less salvages and reinsurance recoveries received, in connexion with the same premiums, also any agency and office expenses. At the end of the year the

balance of the account is brought down and shown as a liability in the Balance Sheet. Thus no profit or loss is shown for the first year and no liability set up for outstanding claims. In the following year, the balance brought down is shown as the opening entry on the income side and any claims paid and/or returns in respect of the preceding year's premiums are shown on the expenditure side, and the balance again brought down, while in the third year the account opens with the balance brought down from the second year and on the opposite side are shown any claims paid and/or returns in connexion with the same premiums. Before closing the third year's account an estimate is made of the outstanding claims as at that date and the amount thereof shown as a transfer to Underwriting Suspense Account; the remaining balance on the account after deduction of the Underwriter's profit commission is then treated as a profit or loss and transferred to the Profit and Loss Account. Any subsequent claims, etc., arising out of insurances covered by the premiums included in the first year's account are debited against the Underwriting Suspense Account. Under this system it will be comprehended that in any one year there will be three Underwriting Accounts open concurrently, one for the current year's business, one for the second year's business of the preceding year, and one for the third year's business of the year prior to the preceding year, and an Underwriting Suspense Account, e.g. in 1937 there would be a 1937 Underwriting Account, the second year of the 1936 Underwriting Account, the third year of the 1935 Underwriting Account and an Underwriting Suspense Account for all prior years. Lloyd's underwriters are the principal users of this system.

UNDERWRITING SYSTEM—TWO-YEAR BASIS

This system is adopted by the majority of marine companies not required to submit their accounts on a Revenue basis. The procedure is identical with that outlined for the "Three-year" basis except that the account is closed at the end of the year following the year of account. Naturally under this method the amount transferred to Underwriting Suspense Account for outstanding claims requires to be more meticulously calculated. The system finds favour with certain companies as it enables profits to be appropriated earlier

<i>Dr.</i>	UNDERWRITING ACCOUNT, 1936	<i>Cr.</i>
	£ s. d.	£ s. d.
To Claims, 1936		By Premiums, 1936, less
„ General Expenses, in-		Returns, Reinsur-
cluding Agents' Com-		ances and Foreign
mission		Taxes
„ Directors' Fees		
„ Balance carried to Bal-		
ance Sheet		
	_____	_____
	_____	_____

<i>Dr.</i>	UNDERWRITING ACCOUNT, 1935	<i>Cr.</i>
	<i>£ s. d.</i>	<i>£ s. d.</i>
To Claims, Returns, etc., and Commissions on Profits, 1935, settled in 1936		By Balance brought for- ward at 31st Decem- ber, 1935
„ Amount Transferred to Underwriting Sus- pense Account to close 1935		
„ Profit transferred to Profit and Loss Ac- count		
	<hr/>	<hr/>
	<hr/>	<hr/>

The procedure followed under this system is similar to that described in the case of the Fire Revenue Account. A liberal estimate of the liability for outstanding claims is made and included in the account under the heading "Claims paid and outstanding" and shown in the Balance Sheet as a liability. In preparing accounts on this basis the reserve for unexpired risks and the additional reserve should be a substantial percentage of the premium income, which latter, of course, includes all premiums written during the year, less all returns and reinsurances, irrespective of the underwriting year to which they relate. Often, even where this system of accounts is enforced, it will be found that the statistics are maintained on an underwriting basis.

**BRITISH COMPANIES TRANSACTING MARINE BUSINESS
IN THE IRISH FREE STATE**

The Irish Free State Insurance Act, 1936, does not legislate for marine insurance business, hence the preceding remarks require no qualification for British Companies doing marine insurance business in the Irish Free State.

CHAPTER IX

INSURANCE COMPANIES' PROFIT AND LOSS ACCOUNTS

INSURANCE companies amenable to the Assurance Companies Act, 1909, must prepare a Profit and Loss Account in the form set forth in the Second Schedule to the Act, except where the company carries on assurance of one class only and no other business (Section 4 (b)). In the case of those companies transacting one class of business and no other business, the Revenue Account may be so amended as to provide for such items as are not included in the form of Revenue Account set forth in the First Schedule.

En passant it may be noted that the form prescribed by the Act violates the canons of accountancy theory in as much as the income is shown on the left-hand side of the account and the outgo on the right-hand side, although in the books of the company the usual tenets of accountancy apply. Hence it will be appreciated that the items in a company's printed Profit and Loss Account appear on the opposite side of the account to that on which they appear in the company's books. Further, the prefixes "To" and "By" are omitted from the legal form.

The account opens with the "Balance of last year's account," which is the balance brought down at the end of the previous year. Then comes the following heading.

INTEREST AND DIVIDENDS NOT CARRIED TO OTHER ACCOUNTS, LESS INCOME TAX THEREON

In all other Revenue Accounts the title is "Interest dividends and rents," but in the Profit and Loss Account the word "rents" is omitted from the title although the companies ignore the omission on the part of the draughtsman of the Act and include under this caption any income from rents applicable.

As already stated in the preceding chapter under Life Revenue Account, the balance of the Interest, Dividends and Rents Account represents the gross interest, less the United Kingdom tax deducted at source and any amounts charged for sinking funds. In addition,

where any foreign interest is included which has been subject to foreign tax, this tax also will have been deducted.

The interest earned by insurance companies is considered part of the income of the business for the purpose of United Kingdom income tax, even if the interest happens to be foreign interest which has not been remitted to this country (Rule 1, Case V, Schedule "D," Income Tax Act, 1918). The basis of United Kingdom taxation is the previous year's income, so that it is necessary to divide the previous year's interest into that which has already suffered tax by deduction at source or is free of tax and that which has not been taxed; the latter is included in the company's return for taxation in assessment. In the General Ledger an entry is made for the amount of the United Kingdom tax in assessment on such interest, debiting Interest, Dividends and Rents Account and creating a liability which will be shown under the heading "Other sums owing by the company."

If the various Revenue Accounts are not credited with interest, then the total of the Interest, Dividends and Rents Account is included in the Profit and Loss Account, but where life business is transacted and the life interest is not segregated, an apportionment is made and the commensurate amounts transferred to the Life Revenue Account and the Profit and Loss Account.

There are two main reasons why the figure shown as tax deducted from interest, dividends and rents may not always equal the amount calculated at the standard rate of tax on the gross interest. The first is that the tax in assessment is on the preceding year's income and the second is that accrued interest sold is not liable to tax. Some companies make an adjustment in the amount of income tax deducted so as to bring it to the equivalent at the standard rate of tax. Again, there are instances where only the tax withheld at source is included as a deduction from the gross interest and the tax on interest in assessment is included with the provision for general taxation on profits, shown on the opposite side of the Profit and Loss Account, but this procedure is rather uncommon nowadays.

From this plurality of treatment emerges the fact that a comparison, without any qualification, of the interest earnings of the different companies, as indicated in their accounts, may be very misleading and this difficulty is enhanced when consolidated

accounts are issued, but this further factor will be amplified when dealing with amalgamations (Chapter XI).

PROFITS REALIZED (ACCOUNTS TO BE SPECIFIED)

The profits transferred from the various Revenue Accounts are embodied under this section, but in this connexion attention is drawn specially to the concluding paragraph under Life Business (page 110).

OTHER RECEIPTS (ACCOUNTS TO BE SPECIFIED)

This is an omnibus heading which gives the companies discretionary powers as to what accounts shall be shown. Those more generally met with are—

(a) **Profit on Realization of Investments** (page 73). This is the balance of the profits less the losses on realization of investments. From the fact that some companies refrain from taking these to Profit and Loss Account and make a direct transfer to a reserve fund, there is evidently a difference of opinion amongst the companies as to the desirability of disclosing the results of their investment operations in the Profit and Loss Account. So far as the figures represent transactions in connexion with investments appertaining to departments other than life, and therefore subject to United Kingdom taxation, it would seem more appropriate to pass such entries through the Profit and Loss Account.

(b) **Transfer Fees.** It is customary for companies to charge a small fee for registering transfers of its shares or stock. The fee is fixed by the company's Articles of Association and unless the company's Articles have specifically excluded the Section in Table "A" dealing with transfer fees, the fee is 2s. 6d. for each transfer. The Forged Transfers Acts of 1891 and 1892 provide, *inter alia*—

(1) that a company may compensate by a cash payment out of its funds for any loss occasioned through the invalidity of a forged transfer,

(2) that the company may charge a fee for each transfer (i.e. an additional fee) to provide a fund for such compensation,

(3) that the company may pay compensation to a person who has suffered loss from a forged transfer, whether he has contributed to such fund or not.

The Acts do not impose an obligation to compensate, but merely confer a power which the company may exercise if it thinks fit. The provisions apply to the loss incurred by the transferee, as the real owner is entitled to be re-registered, and any dividend paid whilst his name has been off the register must be repaid to him by the company. As a precautionary measure, the majority of companies on receipt of a transfer deed advise the transferor that they have received such a deed purporting to be signed by the transferor and that, unless they receive notice to the contrary within a stated number of days, the transfer will be duly registered, but the company is under no obligation to give this notice, and further, the alleged transferor is not estopped from subsequently impeaching a forged transfer by reason only of his neglect to reply to such notice.

Where a company has adopted the Forged Transfers Acts, the transfer fees received will be credited from the Cash Book direct to Transfer Fees Fund Account, and therefore will not pass through the Profit and Loss Account, but in other cases the items will be credited from the Cash Book to Transfer Fees Account and this account will be closed by a Journal entry to Profit and Loss Account.

Let us now deal with the outgo side of the Profit and Loss Account.

DIVIDENDS AND BONUSES TO SHAREHOLDERS

This generally comprises the interim dividend for the year and the provision for the final dividend which the Directors recommend (page 32). The dividends are usually calculated at so much per share and, except where they are paid free of tax, are subject to deduction of United Kingdom tax at the standard rate in force for the year in which the amount payable becomes due (Finance Act, 1927, Section 39). The necessary entry for the final dividend is to debit Profit and Loss Account and to credit an account "Provision for Final Dividend" bringing the latter down as a liability in the Balance Sheet.

Where a company pays both United Kingdom and Dominion Income Tax on the same part of its income for the same year, relief is allowed subject to a limit of half the rate of United Kingdom Tax (Finance Act, 1920, Section 27). The rate of relief allowed is either the Dominion rate of tax or half the United Kingdom rate, whichever is the lesser, and this rate of relief is applied to the

amount of the United Kingdom assessment. This relief is passed on to the shareholders, which is accomplished by reducing the tax deducted from the dividends. It was laid down in *Sheldrick v. South African Breweries Ltd.* (1923), 1 K.B. 173, 39 T.L.R. 26, that the passing on of this relief also applied to preference shareholders.

There is an accepted maxim that an insurance company should pay its dividends out of its interest earnings, ploughing back the underwriting profits, etc., to augment the reserves, and from this has emanated the theory that the possibility of the market advancement of insurance shares may be gauged from the disparity between the net interest earnings and the dividend payments appearing in the Profit and Loss Account. While this may be quite satisfactory as a general theorem there are other factors which modify its general application, and, furthermore, carrying this maxim to its logical conclusion, ultimately the time must arrive when the amassing of underwriting reserves will reach such dimensions that some portion will have to be disseminated, and if the capital structure is incapable of absorbing the surplus, i.e. the shares are fully paid and the whole of the authorized capital issued, the only available outlet will be in the form of dividends, except in the case of life business, where the excess could be distributed in the form of bonus to the participating policy-holders.

Bonuses to shareholders may take the form of cash payments or distribution of shares (either fully or partly paid). In the latter case the bonus may be provided wholly or partly out of a General Reserve Fund or out of the profits disclosed by the quinquennial valuation of the Life Funds. If the bonus is paid in cash it will be shown as a separate item in the Profit and Loss Account. If the bonus takes the form of shares and the whole of the amount is provided out of a General Reserve Fund, either the entry can be made to the debit of the General Reserve Fund and to the credit of Capital Account, or two entries may be made, the first debiting the General Reserve Fund and crediting Profit and Loss Account, and the second debiting Profit and Loss Account and crediting Capital Account. Should the bonus be provided partly out of a General Reserve Fund and partly out of unappropriated profits, the entries would then be to debit the General Reserve Fund with the amount it is contributing

to the bonus and credit Profit and Loss Account and to debit Profit and Loss Account and credit Capital Account with the paid up amount of the shares issued as a bonus. When the bonus is provided either partly or wholly out of the Life Fund, the Life Revenue Account is debited with the amount provided from this source, and the Profit and Loss Account credited, while a second entry is made debiting Profit and Loss Account and crediting Capital Account.

If the company has issued any debentures or debenture stock, the interest, less tax, paid during the year in connexion therewith is shown as the next item in the Profit and Loss Account.

EXPENSES NOT CHARGED TO OTHER ACCOUNTS

The types of expenditure embodied by the companies within the compass of this heading are diverse. By some companies it is reserved for the expenses of their investment department, while others include thereunder certain general expenses which cannot be appropriated to any of the various underwriting departments, e.g. the cost of inspectors' motor cars, the cost of equipment of mechanical appliances for accounting, etc.

LOSSES REALIZED (ACCOUNTS TO BE SPECIFIED)

As the various underwriting departments' profits appear on the opposite side of the Profit and Loss Account so any losses sustained by underwriting departments are shown under this heading.

OTHER PAYMENTS (ACCOUNTS TO BE SPECIFIED)

While this heading is for payments, companies also include thereunder provisions for payments to be made, and amongst those more usually met with are—

(a) **Provision for United Kingdom Income Tax.** For the purpose of United Kingdom taxation the profits of an insurance company, which are assessed under Schedule "D," consist of the underwriting profits of the various departments together with the interest earnings and the profits less losses on realization of securities, but as explained under "Taxation of Life Insurance Business" (page 98) the life business is treated as a separate business. The underwriting profit

is arrived at by deducting from the written premiums the incurred claims, commission and expenses of management and making the necessary adjustment for unexpired risks. Any expenses not allowable under the Income Tax Act are, of course, written back together with any expenditure of a capital nature which has been included in the expenses of management. A company is entitled to set off the loss of one department against the profits of other departments. The present basis of taxation is the previous year's income. The method of assessing the interest earnings has already been exemplified. The assessable amount of profits and losses on realization of investments is found by extracting from the cards or loose leaves containing the details of securities sold, referred to in Chapter VII, page 70, the differences between the actual cash paid for the security and the cash received on realization, irrespective of any accrued interest included in either. This resultant figure will not agree with the balance of the Profits and Losses on Realization Account owing to the adjustment of the accrued interest and the fact that the book value of some of the securities which have been sold may have been written down in previous years. Where the investments representing the various funds are not segregated, it is necessary to apportion the profits and losses on realization according to some agreed basis, so that the proportion applicable to the life business can be eliminated from the return, as the profits on realization of investments are not assessable in the case of Life business if, as is usual, the company is assessed on the basis of its interest earnings. Depreciation or appreciation of investments is not taken into account in arriving at the amount of the assessment until the actual disposal of the investment, but where an investment is changed under some conversion scheme, the difference between the market price of the substituted new stock and the cost of the original stock is taken into account (*Royal Insurance Co. Ltd. v. Stephen*, K.B. 14 T.C. 22). The underwriting profits and the profits less losses on realization of investments are assessed under Case I of Schedule "D," while the interest is assessed under Cases III, IV, and V of the same Schedule. The assessment notices are received some time during the last three months of the year and the tax is payable on the following 1st January; consequently, if the company's year ends on the 31st December, it is necessary

to set up a provision for this liability. If the liability for the tax on interest has not been provided for on the opposite side of the Profit and Loss Account (page 141), then the total of the assessments is shown under this heading, but on the other hand if the tax on interest has been deducted from the interest, only the Case I assessment is debited under this caption. Some companies analyse their assessment under the various classes of business and make the necessary debit for taxation in the relevant Revenue Account.

As previously stated, profits are assessed on the basis of the preceding year's results, which practice admits of the possibility of a company having to provide in a lean year a substantial amount for tax based on extensive profits of the preceding year and vice versa. With the object of eliminating this distortion, certain schools of thought advocate the setting up of the provision for tax calculated on the current year's profits so that each year's results carries its own liability to tax. While the principle has much to commend it, its application may give rise to complications where an alteration in the standard rate of tax is not envisaged at the time the accounts are completed.

(b) **Foreign Taxation** and (c) **Bad Debts**. If these items are not shown in the respective Revenue Accounts they will be included in the Profit and Loss Account (pages 116 and 117).

(d) **Directors' Fees**. As mentioned previously, Section 128 of the Companies Act, 1929, requires the total remuneration paid to Directors to be shown in the accounts. Unless the Profit and Loss Account is a consolidated one, any remuneration received by the parent company's directors from subsidiary companies will be omitted, and, on the other hand, if the account is a consolidated one, the item "Directors' Fees" will include the fees paid by subsidiary companies to their Directors, some of whom may not be Directors of the parent company; consequently, a footnote is generally added giving the information required to comply with this regulation.

(e) **Amounts Written off Buildings**. Such items appear regularly in a number of insurance companies' accounts which emphasizes the inherent strength of British companies. The Profit and Loss Account is debited and the company's Building or Premises Account credited with the amount to be written off. By this means strong

secret reserves are created, as the book value of the premises are reduced considerably below their market value.

(f) **Exchange.** There is a lack of uniformity amongst the companies in the method of dealing with Exchange; some prefer to transfer the balance of this account to Profit and Loss Account, while others analyse the constituent items in the account and transfer to the relevant account—underwriting, interest or asset as the case may be—the portion applicable thereto.

(g) **Losses on Realization.** Where the investment activities for the year have resulted in a debit balance on the Profits and Losses on Realization of Securities Account, in other words when the total losses on realization have exceeded the profits on realization, the balance is included on the expenditure side of the Profit and Loss Account. It will be remembered that these are capital figures and, contrary to the Income Tax computation, do not include accrued interest.

(h) **Transfer to Staff Pension Fund.** This is the amount authorized to be transferred to the Staff Pension Fund. With the view to making the fund ultimately actuarially solvent, this amount is generally in excess of the actual pensions payable and, in addition, the fund is usually credited with interest. The actual pension payments are charged against the fund. If the Directors have sanctioned the conversion of the fund into an irrevocable trust, or the fund has been created from inception as an irrevocable trust, and has been approved as such by the Commissioners of Inland Revenue, the interest on the investments comprising the fund will be free of tax (*vide* Section 32, Finance Act, 1921).

(i) **Transfers to the Various Underwriting Accounts to Increase the Additional Reserves and Transfers to Investment Reserve, etc.** Such transfers need no comment, being self-explanatory.

BALANCE AS PER THIRD SCHEDULE

The balance of the account is the amount of the unappropriated profits, which amount is brought down to form the opening balance of the following year, and is shown as a liability in the Balance Sheet. The majority of companies endeavour to maintain the balance of the Profit and Loss Account approximately constant from one year to another.

BRITISH COMPANIES TRANSACTING BUSINESS IN THE IRISH FREE STATE

There is only an indirect reference to the Profit and Loss Account in the Irish Free State Insurance Act, 1936, and that is in Section 96, which permits the Minister of Industry and Commerce, after consultation with such assurance companies as he thinks fit, or with their representatives, by order, to alter (by addition, omission or variation) all or any of the Schedules (other than the Eighth and Ninth) to the Act of 1909, and, as previously stated, the Profit and Loss Account is the Second Schedule to the 1909 Act.

The form of the Profit and Loss Account set out in the Second Schedule to the Act is shown below—

SECOND SCHEDULE

PROFIT AND LOSS ACCOUNT of the
for the Year ending

19

		£	s.	d.			£	s.	d.
Balance of last year's account					Dividends and bonuses to share-				
Interest and dividends	£ s. d.				holders .				
not carried to other					Expenses not charged to other				
accounts					accounts .				
Less income tax					Loss realized (accounts to be				
thereon					specified)				
Profit realized (accounts to be speci-					Other payments (accounts to be				
fied)					specified)				
Other receipts (accounts to be speci-					Balance as per Third Schedule .				
fied)									
		£					£		

CHAPTER X

INSURANCE COMPANIES' BALANCE SHEETS

THE form the Balance Sheet of insurance companies governed by the Assurance Companies Act, 1909, has to take is set out in the Third Schedule, and is as shown on pages 152 and 153.

Taking the various items of this Balance Sheet in the order in which they appear, we have the following on the liability side—

CAPITAL

The *pro forma* Balance Sheet provides for the showing of the *paid-up* capital only, which resulted in an anomaly in the published Balance Sheets of the companies, as some merely complied with the letter of the Act while others exceeded the requirements of the Act by giving both the authorized and the issued capital. However, the subsequent passing of the Companies Act, 1929, enforcing the showing in every Balance Sheet of authorized and issued capital, has brought all companies into line; the additional information is given, but extended short. While on the question of capital, it is interesting to note that Section 12 of the Assurance Companies Act, 1909, requires any notice, advertisement or other official publication of an assurance company containing a statement of the amount of the authorized capital also to contain a statement of the subscribed and paid-up capital.

VARIOUS INSURANCE FUNDS

These are the balances at the end of the year of the various Revenue Accounts, which in the case of personal accident and employers' liability business include the reserve for outstanding claims.

PROFIT AND LOSS ACCOUNT

This is the balance of a Profit and Loss Account and calls for no special comment except that, should the balance be a debit one instead of a credit one, it would indicate, in the absence of any special circumstances, that the company was in a precarious position.

OTHER FUNDS (IF ANY) TO BE SPECIFIED

The funds usually coming under this heading are Staff Pension Fund, General Reserve, General Contingencies Fund, Investment Fluctuation Fund, Members' Proportion of Life Profits and Transfer Fees Reserved. The inclusion of "Members' Proportion of Life Profits" would occur only in the Balance Sheets of those companies where the total profits due to the members, as shown by the quinquennial valuation, have been transferred to this intermediary account, while Transfer Fees Reserved would be shown only by those companies who fund their transfer fees instead of taking them to the credit of their Profit and Loss Account each year.

The total of the liability side of the Balance Sheet up to this point is cast and constitutes the total funds of the company.

DEBENTURES AND DEBENTURE STOCK

In the Assurance Companies Act, 1909, debentures and debenture stock are not specifically mentioned, but in the Balance Sheet annexed to the Insurance Undertakings Bill the item follows immediately after the funds, so that if the company has issued any debentures or debenture stock, the amount outstanding should be shown in a similar position in a Balance Sheet issued under the Assurance Companies Act, 1909.

CLAIMS ADMITTED OR INTIMATED BUT NOT PAID

The Act provides only for life, fire and bond investment claims but, of course, under this caption also will be shown any outstanding claims in connexion with marine, motor, capital redemption and miscellaneous insurance business where such business is transacted. It will be observed that neither personal accident nor employers' liability outstanding claims are specified under this heading, which is due to the fact that the outstanding claims in connexion with these sections of business are incorporated in the funds.

ANNUITIES DUE AND UNPAID

This is the total of the outstanding annuity payments.

Balance Sheet of the

LIABILITIES		£	s.	d.
Shareholders' capital paid up (if any)	£			
Life assurance funds ¹ —				
Ordinary branch				
Industrial do.				
Annuity fund ¹				
Fire insurance fund				
Accident insurance fund				
Employers' liability insurance fund				
Bond investment and endowment certificate fund				
Marine insurance fund				
Sinking fund and capital redemption fund				
Profit and loss account				
Other funds (if any) to be specified				
		£		
Claims admitted or intimated but not paid ²				
Life assurance				
Fire insurance				
Bond investment				
Annuities due and unpaid ³				
Other sums owing by the company ² (to be stated separately under each class of business).				
		£		

¹ Life companies having separate annuity fund to show amount thereof separately.

² These items are or have been included in the corresponding items in the First Schedule.

NOTE 1. When part of the assets of the company are specifically deposited, under local laws, in various amount compulsorily lodged therein must be specified in respect of each class of business, except that, in a part of the assets has been so deposited.

NOTE 2. A Balance Sheet in the above form must be rendered in respect of each separate fund for which

NOTE 3. The Balance Sheet must state how the values of the Stock Exchange securities are arrived at, in their belief the assets set forth in the Balance Sheet are in the aggregate fully of the value stated therein, business or bond investment business, this certificate is to be given on the occasions only when a statement

NOTE 4. In the case of a company required to keep separate funds under section 3 of this Act, a certificate that no part of any such fund has been applied, directly or indirectly, for any purpose other than the

SCHEDULE

on the

19

ASSETS		£	s.	d.
Mortgages on property within the United Kingdom				
Do. do. out of the United Kingdom				
Loans on parochial and other public rates				
Do. Life interests				
Do. Reversions				
Do. Stocks and shares				
Do. Company's policies within their surrender values				
Do. Personal security				
Investments—				
Deposit with the High Court (securities to be specified)				
British Government securities				
Municipal and county securities, United Kingdom				
Indian and Colonial Government securities				
Do. provincial securities				
Do. municipal do.				
Foreign Government securities				
Do. provincial securities				
Do. municipal do.				
Railway and other debentures and debenture stocks—Home and Foreign				
Railway and other preference and guaranteed stocks				
Do. ordinary stocks				
Rent charges				
Freehold ground rents				
Leasehold do.				
House property				
Life interests				
Reversions				
Agents' balances				
Outstanding premiums ²				
Do. interest, dividends, and rents ²				
Interest accrued but not payable ²				
Bills receivable				
Cash—				
On deposit				
In hand and on current account				
Other assets (to be specified)				
		£		

places out of the United Kingdom, as security to holders of policies there issued, each such place and the case of fire, accident, or employers' liability insurance business, it shall be sufficient to state the fact that

separate investments are made.

and a certificate must be appended, signed by the same persons as sign the Balance Sheet, to the effect that less any investment reserve fund taken into account. In the case of a company transacting life assurance respecting valuation under the Fourth Schedule is made.

cate must be appended, signed by the same persons as signed the Balance Sheet and by the auditor, to the class of business to which it is applicable.

OTHER SUMS OWING BY THE COMPANY

The following accounts will usually be shown under this section—

(a) **Amounts Owing to other Insurance Companies.** This consists of the balance of Reinsurance Companies Account together with the balance of the Reinsurance Reserve Account. Where companies maintain separate control accounts for their issued and obtained guarantee business the balance of the obtained guarantees, in the ordinary course of business, should be a liability being the amount due to other insurance companies, and will be shown under this heading. The issued guarantee business should result normally in an amount due from the other companies and will appear on the asset side of the Balance Sheet under its appropriate heading.

(b) **Current Accounts Owing by the Company.** Amalgamated under this heading are numerous accounts and sometimes, the following accounts, when not separately stated are included—

(c) **Outstanding Dividends.**

(d) **Provision for Final Dividend.**

(e) **Reserve for Taxation.**

(f) **Bills Payable.**

This completes the liability side of the Balance Sheet as required under the Assurance Companies Act, 1909, but the Companies Act, 1929 (Section 125) necessitates, in the case of a parent company owing an amount to a subsidiary company, such an item being shown separately.

ON THE ASSET SIDE

In addition to the division of the various groups of investments into those within the United Kingdom and outside the United Kingdom required by the Act, companies operating in the Irish Free State are required under the Assurance Companies Act, 1909, Irish Free State Adaptation Order, 1928, to give a further subdivision of those within the Irish Free State.

The first three items on the asset side will thus be—

Mortgages on property within the United Kingdom; Mortgages on property within the Irish Free State; Mortgages on property out of the United Kingdom and Irish Free State.

The figures for these three assets are the balances of the capital

control accounts for these investments as shown in the General Ledger.

LOANS

The next six items are the various kinds of loans but there is no distinction necessary here between those in the United Kingdom and those in the Irish Free State. The figures are the balances of the capital control accounts as shown in the General Ledger.

INVESTMENTS

The next item is the most important one on the asset side of the Balance Sheet, and the investments are subdivided into various classes.

Deposit with the High Court (Securities to be Specified). These are the securities deposited in accordance with the Assurance Companies Act, 1909, and the Road Traffic Act of 1930. The balances of the capital columns of the investments in the first section of the subsidiary Investment Ledger are the figures required.

Note 1 at the foot of the Balance Sheet states that where part of the assets of the company is specifically deposited, under local laws, in various places out of the United Kingdom, as security to holders of policies there issued, each such place and the amount compulsorily lodged therein must be specified in respect of such class of business, except that, in the case of fire, accident, or employers' liability insurance business, it shall be sufficient to state the fact that a part of the assets has been so deposited. In conformity with this Note detailed particulars of deposits in respect of life business only are given.

Deposited with Supreme Court of Irish Free State (Securities to be specified). This heading is not in the original Act but the secession of the Irish Free State has caused its inclusion by those companies operating in the Irish Free State. The securities are those deposited under the Irish Free State Adaptation Order, 1928, and the Irish Free State Road Traffic Act, 1933. The balances of the capital columns of the second section of the "S.E.I." Ledger gives these figures.

Then follow the various classes of investments grouped under their distinctive headings. The total shown against each class is

the total of the balances of the capital columns of that section of the subsidiary Ledger containing those investments.

En passant it may be mentioned in connexion with ordinary stocks, that in the *pro forma* Balance Sheet annexed to the Act the abbreviation "Do." appears only under the word "Railway," but the Board of Trade have interpreted this to cover "Railway and Other." It is the practice to include shares as well as stocks where only the latter are mentioned. The total of the individual sections of the investments up to and including "Rent Charges" should agree with the balance of the Investment Capital Control Account in the General Ledger.

Freehold Ground Rents, Leasehold Ground Rents, Life Interests, and Reversions. These investments usually form only a very minor proportion of a company's assets and the amount shown against each item in the Balance Sheet is the balance of the corresponding control account in the General Ledger.

House Property. As previously explained, this asset constitutes the company's buildings and the amount shown thereunder is the balance of the Buildings Account in the General Ledger.

AGENTS' BALANCES AND OUTSTANDING PREMIUMS

The total of these two assets should agree with the Agents' Control Account in the General Ledger. The amount included for "Outstanding Premiums" is the balance of the "Direct Account" shown in the "A.A." Ledger.

OUTSTANDING INTEREST, DIVIDENDS AND RENTS

This is the total of the balances of "Investment Revenue," "Loans on Life Policies Revenue," "Building Revenue" and any other Investment Revenue Accounts.

INTEREST ACCRUED BUT NOT PAYABLE

The balance of the Interest Account brought down as a debit to the following year reduced by the balance of the Income Tax deducted from Interest Account brought down as a credit to the following year's account (pages 73 and 74) produces this item.

BILLS RECEIVABLE

This represents the total of the bills receivable in hand which have not yet fallen due for payment nor been discounted with the bank.

CASH

This item is divided into two parts, viz. (1) On deposit, (2) In hand and on Current Account. The former includes cash placed on deposit for fixed periods as well as amounts "at call" or "short notice." The latter includes both ordinary and petty cash in hand and the balance at the Bank on Current Account. Generally the balance of the Bank Account in the company's Ledger will not agree with the balance as shown by the Bank Pass Book owing to the fact that certain cheques which the company has issued will not have been presented for payment. It is advisable, therefore, to keep a daily reconciliation of the Bank Account, marking off the outstanding cheques as and when they are cleared.

OTHER ASSETS (TO BE SPECIFIED)

Hereunder would appear such accounts as the following—

Amounts Owning by other Insurance Companies. This normally will be the balance of the control account for reinsurance companies in connexion with issued guarantees, if the issued guarantees are kept apart from the obtained guarantees (page 154).

Amounts Owning to the Company. Under a composite heading such as the above, or "Sundry Debtors," etc., designated according to the inclination of the individual company, is amalgamated sundry debit balances.

Shares in Subsidiary Companies ; Amounts owing by Subsidiary Companies. As on the liability side of the Balance Sheet, so on the asset side, the Companies Act, 1929 (Section 125), calls for separate items for "Shares in Subsidiary Companies" and "Amounts Owning by Subsidiary Companies" to be stated. The latter includes any loans made to the subsidiary companies by the parent company which have not been liquidated and any amounts paid or incurred by the parent company on behalf of the subsidiary companies which have not been refunded to the parent company.

The only account remaining in the General Ledger which has not been dealt with is the Branch Control Account. The details aggregating the balance of this account appear on the supplementary statements referred to on page 59 and these are summarized and the total of each class of asset and liability incorporated with the amount already shown for that item in the Balance Sheet.

This completes the asset side of the Balance Sheet, but it now remains to consider the footnotes appended thereto.

Footnote No. 2 requires the rendering of a separate Balance Sheet for each separate fund for which separate investments are made.

Footnote No. 3 calls for—

(a) A statement as to how the values of stock exchange securities are arrived at.

With the majority of companies the values in the Ledger of the stock exchange securities is the actual cost, less any sinking funds applied and any other amounts written off, in which case the position is cared for by a statement to the effect that "The stock exchange securities are included at or below cost." In one or two instances companies, at the end of each year, adjust the book values of their stock exchange investments to the market values at that date by writing up or down the individual securities and, here, the statement will be "The stock exchange securities are included at their market values."

(b) A certificate to be appended, signed by the same persons as sign the Balance Sheet (page 86) to the effect that, in their belief, the assets set forth in the Balance Sheet are in the aggregate fully of the value stated therein, less any investment Reserve Fund taken into account.

In the case of companies writing life and/or bond investment business, the certificate is required only on the occasions of a valuation under the Fourth Schedule, but with companies transacting other kinds of insurance, the valuation of the investments is an annual obligation. Reviewing the various assets for the purpose of justifying the adoption of the certificate, it will be found that practically all mortgages and loans are fully secured; any bad or doubtful debts appertaining to the "Agents' Balances" and/or "Outstanding Premiums" are amply provided for; no defaulted

interest, dividends or rents included in either the "Outstanding Interest" or the "Accrued Interest"; and all the remaining assets, other than the investments, worth their face value, so that the ascertainment of the market value of the investments will complete the investigation.

MARKET VALUE OF STOCK EXCHANGE INVESTMENTS

To compute the market value of the stock exchange investments a columnar book is used with columns as under—

STOCK EXCHANGE INVESTMENTS—VALUATION BOOK

Description of Stock or Shares	Par Value	Book Value	31st December 19 MARKET		Accrued Interest to 31st December	Remarks
			Price	Value		

Each separate security is entered in this book, the details for the Description, Par Value, Book Value and Accrued Interest columns being obtained from the cards or loose leaves, which are filed in order of interest due date, or, if it is desired, the securities may follow the order of the "S.E.I." Ledger, that is in the same order as in the Balance Sheet, in which case the particulars for the first three columns may be copied from the Ledger and the figures for the Accrued Interest be extracted from the cards, item No. 10. On the grounds of economy, this valuation book is generally furnished with fly leaves for the last four columns so that the valuation for a number of years may be compiled without having to rewrite the whole of the details for each security.

Each day the stock exchange is open, an official list is published which gives the closing prices quoted that day for all investments dealt in on the exchange. In the United Kingdom these prices, with the exception of Treasury Bonds and Indian Rupee Paper, include accrued interest to date, and, as the accrued interest forms

a separate entity in the Balance Sheet, in order to compare the market value with the book value of the stock exchange investments, as depicted in the Balance Sheet, which is the capital value excluding any interest, it would be necessary to reduce each listed price to an ex-dividend basis. By utilizing an accrued interest column in the Valuation Book, this calculation for each investment is obviated, except as regards any non-fixed interest bearing securities which the company may possess. For an obvious reason the records for these latter investments have no amount filled in against "Accrued Interest to the end of the year" and, as the market price of such securities often incorporates accrued interest based on past results, before arriving at the ex-dividend market value the market price has to be adjusted to an ex-dividend price. Some companies take the lower of the two prices quoted in the official list, whilst others take the mean of the two prices, but, whichever method is favoured, the price is inserted in the "Market Price" column. The market value is obtained by multiplying the par value of each investment by its corresponding market price, and the result is entered in the "Market Value" column. As regards foreign securities, in the case of those which are dealt in on the United Kingdom stock markets any differences arising from variations in the rate of exchange will have been taken into consideration in the quoted prices, but anent those not listed on the United Kingdom stock exchanges, an allowance for this factor of exchange will have to be made in calculating the market value. On casting the "Book Value," "Market Value" and "Accrued Interest" columns, the total of the "Book Value" column will agree with the total of the "Investments" appearing in the Balance Sheet and the "Accrued Interest" column will tally with the total of the accrued interest on investments, which latter item constitutes the major part of the amount under the heading in the Balance Sheet "Interest accrued but not payable." To ascertain the ex-dividend market value of the investments for comparison with the book value as in the Balance Sheet, the total of the "Accrued Interest" column is subtracted from that of the "Market Value" column. The result thus obtained is subject to an adjustment on account of certain American and other similar securities, which are not dealt in on the United Kingdom exchanges and the prices for which have been called from the New York or other price lists, in

which lists the market prices exclude any interest accrued to date. It will be apparent that the computed market value of such securities will be an ex-dividend one. As the accrued interest appertaining to such securities will have been extracted from the cards or loose leaves and incorporated in the "Accrued Interest" column, thus forming part of the sum deducted from the original total "Market Value" to arrive at the ex-dividend market value, such accrued interest should be added back to the result previously ascertained. The attributes of this system are that it definitely curtails clerical labour and simultaneously evolves a stringent valuation, stringent, in so far that the accrued interest contained in the official list prices invariably is less than that appearing in the company's records. Taking an extreme example; British Government 4% Consolidated Loan, 1957, is marked "ex-dividend" practically the last day of the year although the interest is not due until the 1st February; thus while the market price at the 31st December is an ex-dividend one there will be included in the "Accrued Interest" column five months' interest. The certificate calls for the aggregate position as opposed to that of individual classes of assets, hence, should the market value of the investments disclose only a slight deficiency, possibly it might be offset by a surplus in the value of the buildings above their written down value. Failing the existence of such an expedient or depreciation still being extant even after applying any such relief, it would be incumbent upon the company to create an Investment Reserve Fund for the amount of the shortage either out of its unappropriated profits or by utilizing part of a general reserve.

Footnote No. 4 states that in the case of a company required to keep separate funds under Section 3 of the Act, a certificate must be appended signed by the same persons as signed the Balance Sheet and by the auditor, to the effect that no part of any such fund has been applied directly or indirectly for any purpose other than the class of business to which it is applicable.

Owing to the violent fluctuations in the rates of exchange during recent years, the Board of Trade have requested offices, having assets and/or liabilities in foreign currencies, to indicate on their returns how the conversions into sterling have been calculated, whether by taking the par of exchange, the market rate at the date

to which the accounts are made up, an average rate for the period, or how otherwise.

In addition to the above certificates required in connexion with the Assurance Companies Act, 1909, there are the enactments under the Companies Act, 1929, to be complied with, namely, Section 124, which, *inter alia*, calls for a statement as to how the value of the fixed assets has been arrived at, and where any liability is secured on any assets otherwise than by operation of law, a statement to that effect; Section 126 which requires a statement as to how the profits and losses of subsidiary companies have been dealt with so far as the holding company's accounts are concerned, and to what extent and where provision for losses of subsidiary companies have been made; Section 128 which necessitates the showing of the amount of any loans made during the period of the accounts to directors or officers, including any such loans which were repaid during the year in question, and the amounts of any loans made to directors or officers prior to that period and still outstanding. As explained on page 35, this last Section is subject to certain modifications.

AUDIT OF COMPANIES' ACCOUNTS AND BALANCE SHEETS

The audit of the accounts and Balance Sheets of those companies which come within the purview of the Companies Act, 1929, is controlled by the following Sections—

Section 129 which stipulates that the auditors' report shall be attached to the Balance Sheet and shall be read before the company in general meeting and shall be open to inspection by any member.

Section 132 requires every company at each annual general meeting to appoint an auditor or auditors to hold office until the next annual general meeting, and to fix their remuneration. If this is not done, the Board of Trade may, on the application of a member of the company, appoint an auditor for the current year and fix his remuneration. A person, other than a retiring auditor, cannot be appointed unless fourteen days' notice prior to the meeting has been given to the company by the member nominating the proposed auditor, and the company have given notice to the retiring auditor and to the members at least seven days before the annual general meeting. This Section empowers Directors to fill any casual vacancy.

Section 133 specifies those who are disqualified from appointment as auditors, viz. (a) a Director or officer of the company, (b) except where the company is a private one, any person who is a partner of, or in the

employment of, an officer of the company, (c) a body corporate, but as regards (c) if the appointment was made before the 3rd August, 1928, the disqualification does not operate, but otherwise any body corporate acting as auditor of a company shall be liable to a fine not exceeding £100.

Section 134 intimates that the auditors shall make a report to the members on the accounts examined by them and on every Balance Sheet laid before the company in general meeting. The report must state whether or not they have obtained all the information and explanations they have required and whether, in their opinion, the Balance Sheet is properly drawn up so as to exhibit a true and correct view of the company's affairs according to the best of their information and the explanations given to them and as shown by the books of the company. This Section also gives the auditors a right of access at all times to the books, accounts and vouchers of the company and entitles them to attend any general meeting of the company at which accounts they have examined and reported on are being laid before the members and also permits them to make any statement or explanation they desire with respect to the accounts.

The appointment and powers of auditors in the cases of those companies incorporated by Special Act of Parliament and not, therefore, subject to the Companies Act, 1929, are provided for in the Companies Clauses Consolidation Act, 1845, Clauses 101-108 of which deal with the appointment and duties of auditors. These state, except where the Special Act incorporating the company provides otherwise, two auditors must be appointed, who retire alternately each year. Each auditor must hold at least one share in the undertaking, but this has been repealed as far as railways are concerned by the Regulation of Railways Act, 1868. The Directors must deliver to the auditors the half-yearly or other periodical accounts and Balance Sheet, and the auditors must examine the same, and either make a special report on the said accounts, or confirm them. The auditors have power to employ such accountants and any other persons as they may think proper at the expense of the company.

Section 9 of the Assurance Companies Act, 1909, empowers the Board of Trade to prescribe in what manner the accounts of those companies shall be audited which do not come within the scope of either the provisions of the Companies Consolidation Act, 1908—now superseded by the Companies Act, 1929—or of the Companies Clauses Consolidation Act, 1845, and the manner prescribed by the Board of Trade is incorporated in the

Board of Trade Order dated 6th June, 1910, No. 566, which is as follows—

Rules Relating to the Audit of Accounts of Assurance Companies

(1) The accounts of every assurance company not subject to audit in accordance with the provisions of the Companies (Consolidation) Act, 1908 (now the Companies Act, 1929), or of the Companies Clauses Consolidation Act, 1845, relating to audit shall be audited in accordance with the provisions of Section 113 (1) and (2) of the Companies (Consolidation) Act, 1908. These sections are now re-enacted in the Companies Act, 1929, Section 134 (1) and (2).

(2) No director or officer of the company shall be capable of being appointed an auditor.

(3) In the case of a company having a share capital, the auditor or auditors shall be elected annually by the shareholders.

**BRITISH COMPANIES TRANSACTING ASSURANCE BUSINESS
IN THE IRISH FREE STATE**

When the Minister of Industry and Commerce decrees by order that the Irish Free State Insurance Act, 1936, shall come into operation, companies will be constrained to submit a Balance Sheet consistent with this statute, unless the Minister has agreed to accept the company's own government returns in lieu of those demanded under the Act. The principal variations from the present form will be the segregation of the life assets of the Irish Free State Life Fund (in the case of those companies doing this class of business), a possible rearrangement of deposits, and the appearance of an item representing the outstanding premiums of the mechanically propelled vehicle business in the Irish Free State. Then, as regards the certificates to be appended to the Balance Sheet, in addition to those already supplied the more stringent ones recited in Section 101 of the Act (page 93) will have to be completed.

CHAPTER XI

AMALGAMATIONS, RECONSTRUCTIONS, AND WINDING UP OF INSURANCE COMPANIES

AMALGAMATIONS AND RECONSTRUCTIONS

UNDER the Assurance Companies Act, 1909 (Section 13), where it is intended to amalgamate two or more companies or to transfer the assurance business of any class from one company to another, the directors of any one or more such companies may apply to the Court to sanction the proposed arrangement and if the Court, after hearing the directors and any other persons it considers entitled to be heard, is satisfied that there is no sufficient objection it may sanction the arrangements, but before any application is made to the Court the following conditions must be fulfilled—

(1) Notice of the intention to make application must be published in the *Gazette*.

(2) If the proposal is to amalgamate or to transfer life or bond investment business, unless the Court directs otherwise, a statement giving the following information shall be transmitted to each life, endowment, sinking fund or bond investment policy-holder of each company; the nature of the amalgamation or transfer, together with an abstract containing the material facts embodied in the agreement and copies of the actuarial or other reports upon which the agreement is founded including a report by an independent actuary.

(3) The agreement shall be open for inspection by the policy-holders and shareholders at the offices of the companies for a period of fifteen days after the publication in the *Gazette*.

Section 13, however, is restricted so far as life business is concerned by Section 30 (d), which enacts that the Court shall not sanction the amalgamation or transfer if life policy-holders representing one-tenth or more of the total amount assured dissent from the arrangement. Section 31 (f) and 32 (e) nullify Section 13 where fire and/or accident business only are the subjects of amalgamation or transfer.

Under Section 14 of the Act, where an amalgamation or transfer of business takes place, the combined company or the purchasing

company must deposit the following documents with the Board of Trade within ten days of the completion—

(a) Certified copies of statements of the assets and liabilities of the companies concerned, together with a statement of the nature and terms of the amalgamation or transfer.

(b) Certified copy of the agreement under which the amalgamation or transfer is effected.

(c) Certified copies of the actuarial or other reports upon which the agreement is founded.

(d) A declaration under the hand of the Chairman and the principal officer of each company that to the best of their belief every payment on account of the amalgamation or transfer is therein fully set forth, and that within the knowledge of any of the parties to the agreement there have not been nor will there be any other payments either in money, policies, bonds, valuable securities or other property beyond those set forth.

In the case of insurance companies incorporated under the Companies Acts, the regulations laid down in the Companies Act, 1929, will have to be complied with, which are in addition to the requirements of the Assurance Companies Act, 1909.

SECTIONS OF THE COMPANIES ACT, 1929, DEALING WITH AMALGAMATIONS AND RECONSTRUCTIONS

Where a compromise or arrangement is proposed between a company and its creditors or any class of them, or between a company and its members or any class of them, on the application of any of the parties, the Court may order a meeting of those concerned to be held. If a majority in number representing three-fourths in value of those concerned present and voting at the meeting agree to the compromise or arrangement, if sanctioned by the Court, it shall be binding on all concerned (Section 153).

Where an application is made to the Court under Section 153 and it is shown that the compromise or arrangement is in connexion with a scheme of reconstruction or amalgamation and that under the scheme the whole or part of the undertaking is to be transferred to another company, the Court may make provision for this either in the order sanctioning the scheme or by a subsequent order, as well as for all or any of the following—

(1) The allotting of any shares, debentures, policies or other like interests.

(2) The dissolution of the company without winding up.

(3) The provision to be made for any persons who, within such time and in such manner as the Court direct, dissent from the compromise or arrangement.

(4) Any other matters necessary for the effectual carrying out of the reconstruction or amalgamation. (Section 154.)

These two Sections apply in the case of companies not in the course of being wound up. Where a company is proposed to be or is in course of being wound up voluntarily and the whole or part is proposed to be transferred to another company, the liquidator may, with the sanction of a special resolution of the company, receive for distribution among the members shares, policies or other interest in the latter company. This arrangement is binding on all the members of the former company, but provisions are made for satisfying any dissenting member who did not vote in favour of the special resolution (Section 234). In a creditor's voluntary winding-up the same conditions apply except that the liquidator's authority must be obtained either from the Court or the committee of inspection (Section 243).

Any amalgamation or transfer of insurance companies not incorporated under the Companies Act will require to be approved in the manner provided for by the companies' own constitution.

The necessary book-keeping entries for any of these amalgamations or transfers is dependent entirely upon the terms of the agreement.

MODERN PRACTICE

To avoid the difficulties attending amalgamations and transfers, the modern practice is for the principal company to acquire the majority of the shares of the subsidiary company or companies and so obtain a controlling interest, while the subsidiary companies retain their individual identity and existence.

The consideration payable to the members of the subsidiary company may consist of (a) shares in the parent company, and/or (b) debentures issued by the parent company, and/or (c) cash.

As regards (a) if the parent company's authorized capital has not been wholly issued, its obligations under the purchase agreement can be met by issuing the requisite number of shares, or, should the

whole of the authorized capital already be issued, the company may increase its share capital under Section 50 of the Companies Act, 1929, to the necessary extent. The book-keeping entry would be to credit Capital Account and to debit Shares in Subsidiary Companies Account, the latter account forming one of the parent company's investments.

As regards (b) the entry would be to credit Debentures or Debenture Stock Account and to debit Shares in Subsidiary Companies Account. The objection to financing the purchase of a subsidiary company by the creation of debentures is that debentures are usually secured by either a floating or a fixed charge on certain assets, which assets represent the accumulated funds necessary for security against insurance liabilities, and, consequently, the indebtedness created by the issue of debentures adds to the liabilities already carried by the parent company without supplying any additional effective assets, as the assets acquired under the amalgamation already carry their full share of insurance liability. Thus the financial strength of the parent company may be considerably jeopardized by the creation of this extraneous liability.

As regards (c) sufficient cash to pay off the shareholders of the subsidiary company may materialize from the realization of securities, in which case the effect on the Balance Sheet is simply a transfer from one class of asset to another. Alternatively, the company may decide to make a public issue of so many of its shares at a price which will produce the required cash. Generally speaking, the market value of insurance shares is greatly in excess of the nominal value, so that a Share Premium Account (page 30) will be created.

LEGAL AND CONSOLIDATED ACCOUNTS, ETC.

It was laid down in *Salomon v. Salomon & Co. Ltd.*, [1897] A.C. 22, that a company is a distinct and separate legal entity from the members comprising the company, consequently where an amalgamation takes place and the company taken over maintains its individual corporate existence there is no legal justification for treating the subsidiary company in the books of the parent company otherwise than as an investment. The assets and liabilities of a subsidiary company are not the parent company's, the parent

company merely being a shareholder. However, several of the larger insurance companies, in their books, merge the figures of their subsidiary companies, so that instead of the Revenue Accounts, Profit and Loss Account, and Balance Sheet showing the results of the parent company only, they represent consolidated results, and in order to comply with the Companies Act, 1929, such companies have found it incumbent on them to furnish, in addition to the consolidated Balance Sheet, a legal Balance Sheet. Of recent years commercial opinion has advocated the publication of consolidated accounts and Balance Sheets in addition to legal accounts and Balance Sheets on the axiom that a group statement shows the economic as opposed to the legal position, but, as stated above, several of the leading insurance companies, while publishing consolidated Revenue Accounts and Profit and Loss Accounts, do not publish the corresponding legal accounts. A consolidated statement on its own may be liable to misinterpretation by creditors of the parent company in so far that they may regard the assets of the whole group as a common fund, which is incorrect, as their only recourse is against the assets of the parent company. Further, the practice of merging the figures of live subsidiary companies with those of the parent company and issuing consolidated Revenue and Profit and Loss Accounts only, results in the parent company's dividends being contrasted with the consolidated interest earnings and underwriting profits, whereas they should be set against only the parent company's interest earnings (which include the dividends received from subsidiary companies) and the parent company's underwriting profits.

The prevalency of the practice of merging subsidiary companies' accounts with the parent company's warrants a cursory résumé of the book-keeping procedure.

In the parent company's books, the subsidiary company is treated exactly as a branch office. An account is opened in the name of the subsidiary company, to which is debited the purchase price. This price will represent the capital, the balance of the Profit and Loss Account and any free funds of the subsidiary company, together with any amount paid for goodwill, the latter being written off as soon as possible. When the accounts are received from the subsidiary company, either annually, or at more frequent intervals,

the premiums appearing therein are credited to the parent company's Premium Account and debited to the Subsidiary Company Account, while the claims, commission, expenses of management, etc., are debited to the relevant parent company's accounts and credited to the Subsidiary Company Account. The subsidiary company's interest, dividends and rents are credited to the Interest Account in the parent company's Ledger and debited to Subsidiary Company Account and similar entries made for any other revenue items. Any dividends received from the subsidiary company are treated as cash remittances and debited to Cash or Bank Account and credited to Subsidiary Company Account. A reserve is established in the parent company's Ledger for the amount of shares held by any outside shareholders. The balance of the Subsidiary Company Account in the parent company's Ledger will then represent the subsidiary company's assets plus any amount for goodwill not yet written off, less its liabilities, or, to put it another way, the subsidiary company's capital, the balance of its Profit and Loss Account, any free funds and the balance of goodwill (if any). When preparing the Balance Sheet, the balance of the Subsidiary Company Account is dissected into its component assets and liabilities and these are incorporated with those of the parent company.

WINDING UP OF ASSURANCE COMPANIES

Section 15 of the Assurance Companies Act, 1909, enacts that the Court may order the winding up of an assurance company in accordance with the Companies (Consolidation) Act, 1908 (now superseded by the Companies Act, 1929), and that the provisions of that Act shall apply, subject to the following modification—

The company may be ordered to be wound up on the petition of ten or more policy-holders owning policies of an aggregate value of not less than ten thousand pounds. Provided that such petition shall not be presented except by the leave of the Court, and leave shall not be granted until a *prima facie* case has been established to the satisfaction of the Court and until security for costs for such amount as the Court may think reasonable has been given.

Section 156 of the Companies Act, 1929, gives the various modes of winding up companies: (a) by the Court, (b) voluntary, (c) subject to the supervision of the Court.

Section 168 enumerates the cases in which a company may be wound up by the Court, amongst which may be mentioned that of being unable to pay its debts, and Section 225 the cases in which it may be wound up voluntarily. Application to the Court for winding up has to be by petition presented by the company and/or creditors and/or contributories.

ASSURANCE COMPANIES (WINDING UP) ACT, 1933

This Act, which does not extend to Northern Ireland, provides for the winding up of insolvent assurance companies and enacts that a petition for the winding up of an assurance company on the ground that it is unable to pay its debts within the meaning of Sections 168 (see above) and 169 of the Companies Act, 1929, may, with the leave of the Court, be presented by the Board of Trade. (Section 1.)

If it appears to the Board of Trade that there is reasonable ground for believing that an assurance company is insolvent it may, by notice in writing to the company, require to be furnished with such explanations, information, accounts, Balance Sheets, abstracts and statements as they consider necessary to determine whether the company is insolvent and may require these to be signed by directors and officers and certified by an auditor and/or an actuary. If the company does not comply with the request before the expiration of the time limited by the notice, the Board of Trade may apply to the Court, who may order all or any of such requirements to be complied with within a certain time. If default is then made, it shall be a ground upon which the company may be wound up. Upon application being made by the Board of Trade, the Court may, by order, grant leave to the Board of Trade to present a petition for winding up upon the ground of default, or alternatively, direct the Board to appoint one or more inspectors to investigate the affairs of the company and report thereon, and also give directions as to the payment of the costs of the investigation. (Section 2.)

Section 3 of the Act intimates that the rules made under Section 305 of the Companies Act, 1929, may regulate the procedure and practice to be followed in the case of proceedings under this Act, and where inspectors are appointed under the Act, subsections (3), (4), and (5) of Section 135 of the Companies Act, 1929, shall apply.

Section 135 (3) of the Companies Act, 1929, compels all officers and agents to produce to inspectors all documents and books in their custody or power, subsection (4) empowers inspectors to examine on oath, while subsection (5) authorizes the Court to punish any officer or agent who refuses to produce such documents or books or refuses to answer any questions as if he had been guilty of contempt of court.

It will be observed that under this Act the Board of Trade can take action only where there is reasonable ground for believing that an assurance company is insolvent. This was not considered sufficient protection against unsound companies and consequently a further Act was passed in 1935 which has extended the powers of the Board of Trade in the following manner.

ASSURANCE COMPANIES (WINDING UP) ACT, 1935

This Act amends Section 2 of the Assurance Companies (Winding Up) Act, 1933, by entitling the Board of Trade to call at any time for the documents, etc., referred to in Section 2 of the latter Act, for determining whether the company is insolvent, or was insolvent at any date not earlier than the close of the period to which the last deposited accounts and Balance Sheet of the company relate. If the company does not comply with the request before the expiration of the time limited by the notice, the Board may serve upon the company a notice in writing stating that they propose to appoint one or more inspectors to investigate the affairs of the company and to report thereon. Unless the company object in writing within seven days from the date of the service of the notice the Board may make the appointment; on the other hand should the company object in writing within the seven days, the Board may apply to the Court for leave to make the appointment, which will be granted unless the Court is satisfied by the company that the appointment cannot reasonably be required for the purpose. As in the case of the 1933 Act, subsections (3), (4), and (5) of Section 135 of the Companies Act, 1929, apply where an inspector is appointed. Any refusal which, under subsection (5) of Section 135 of the Companies Act, 1929, would be ground for punishment, is also a ground upon which the company may, on the petition of the Board presented by leave of the Court, be wound up by the Court in accordance with the

provisions of the Companies Act, 1929. Subsection (5) of Section 1 provides that the expenses of the investigation shall be defrayed by the Board, provided that where the Court grants leave to make the appointment it may direct the company to repay the Board, and if an order for the winding up of the company by the Court is made within twelve months from the date the inspector's report is made to the Board, the expenses shall be paid out of the assets of the company *pari passu* with the taxed costs of the petition.

The expenses incurred by the Board shall be defrayed out of moneys provided by Parliament.

WINDING UP OF SUBSIDIARY COMPANIES

Section 16 of the Assurance Companies Act, 1909, deals with the winding up of subsidiary companies, and lays down that if the principal company is being wound up by the Court, or under the supervision of the Court, and in pursuance of the arrangements whereby the business of the subsidiary company was transferred to the principal company, the subsidiary company, or the creditors of the subsidiary company, have claims against the principal company, the Court shall order the winding up of the subsidiary company in conjunction with the principal company and may appoint the same person to be liquidator for both companies being wound up as if they were one company (subsection 1). The commencement of the winding up of the principal company shall be the same for the subsidiary company unless otherwise ordered by the Court (subsection 2). The Court may not order the winding up of a subsidiary company in conjunction with the principal company unless it considers it just and equitable (subsection 4). Where a company is a principal to one company and a subsidiary to another, or where there are several subsidiaries to one principal company, the Court may deal with the companies together or in separate groups whichever is most expedient (subsection 6).

The financial relations existing between such principal and subsidiary companies are usually so involved that the only practical course is to wind them all up together.

It should be noted that to constitute a subsidiary company within Section 16 of the Act there must be a transfer of the business of the company, or part of it, to the principal company, and it was

laid down in *Re The Lancashire Plate Glass, Fire and Burglary Insurance Co. Ltd.*, 8 L.J. Ch. 199, that "one company by purchase of a majority of the shares of the other company, does not so acquire part of the business, it becomes a principal shareholder in the business, but not a transferee."

THE COMMENCEMENT OF THE WINDING UP

Section 170 of the Companies Act, 1929, decrees that an application to the Court for the winding up of a company shall be by petition, and Section 175 enacts that where, before the presentation of a petition for the winding up by the Court, a resolution has been passed by the company for voluntary winding up, the winding up shall be deemed to have commenced at the time of the passing of the resolution. In any other case, the winding up of a company by the Court shall be deemed to commence at the time of the presentation of the petition. Section 227 dates the commencement of a voluntary winding up as the time the resolution for voluntary winding up is passed.

POLICY-HOLDERS IN A WINDING UP

As from the commencement of the winding up the company ceases to carry on its business, and consequently policy-holders and others interested under the policies are creditors and as such entitled to claim against the company. Section 17 of the Assurance Companies Act, 1909, indicates that in the winding up of an assurance company the value of a policy or the liability under a policy shall be estimated in accordance with the provisions of the Sixth Schedule.

The rules for valuing policies and liabilities as set out in the Sixth Schedule are as follows—

Rules for Valuing Current Policies. Fire and personal accident policies are valued at such portion of the last premium paid as is proportionate to the unexpired portion of the period in respect of which the premium was paid.

Life policies are valued at the difference between the present value of the reversion in the sum assured, according to the contingency upon which it is payable, including any bonus or addition made thereto before the commencement of the winding up, and the present value of future annual premiums. The rate of interest to

be assumed and the mortality tables to be used in calculating such present values are as the Court may direct, and the premium calculated at the said rate of interest and rate of mortality is to be sufficient to provide for the risk incurred by the office in issuing the policy, exclusive of any addition for office expenses and other charges.

Employers' liability policies are valued at such portion of the last premium paid as is proportionate to the unexpired portion of the period in respect of which the premium was paid, together with, in the case of a policy under which any weekly payment is payable, the present value of that weekly payment.

Bond investment policies or certificates are valued at the difference between the present value of the sum assured according to the date at which it is payable, including any bonus or addition made before the commencement of the winding up, and the present value of the future annual premiums. Here again in calculating the present values interest is to be assumed at such rate as the Court may direct and also the premium is to be sufficient to provide for the sum assured calculated at the said rate of interest, without any addition for office expenses and other charges.

An annuity is valued according to the tables used by the company at the time the annuity was granted, and where they cannot be ascertained or adopted to the satisfaction of the Court, then according to such rate of interest and tables of mortality as the Court may direct.

Valuing of Liabilities under Policies. The rule for valuing a periodical payment under personal accident policies in the case of total permanent incapacity is such an amount as would purchase from the National Debt Commissioners through the Post Office Savings Bank a life annuity equal to 75 per cent of the annual value of the periodical payment, and, in any other case, such proportion of such an amount as may, under the circumstances of the case, be proper.

The rule for valuing a weekly payment under employers' liability policies if the incapacity of the workman in respect of which it is payable is total permanent incapacity is such an amount as would purchase from the National Debt Commissioners through the Post Office Savings Bank an immediate life annuity for the workman

equal to 75 per cent of the annual value of the weekly payment, and in other cases such proportion as may, in the circumstances of the case, be proper.

In the case of other claims, the amount for which a policy-holder is entitled to prove depends upon the date at which the claim takes place. If the claim has arisen before the commencement of the winding up, the policy-holder is a creditor for the full amount of claim when ascertained. However, as the policy ceases at the commencement of the winding up, he is not entitled to make a claim in respect of a loss which takes place afterwards, the statutory valuation of his contingent claim not being affected by the subsequent happening of the contingency.

Position in Event of Non-payment of Premium. Provided the winding up commenced before the days of grace expired or before the premium became due, the right of a policy-holder to prove is not affected by the non-payment of the premium.

SEVENTH SCHEDULE

In the case of a company being wound up by the Court, or subject to the supervision of the Court, it is the duty of the liquidator to ascertain the value of the company's liability to each of the persons appearing by its books to be entitled to or interested in the policies granted by it, and to give notice of such value to them in such a manner as the Court may direct. Any person to whom notice is given is to be bound by the value so ascertained, unless he gives notice of his intention to dispute such value in the manner and within the time prescribed by the Court.

REDUCTION OF CONTRACTS

Where an assurance company has been proved to be unable to pay its debts, instead of making a winding up order the Court may reduce the amount of its contracts upon such terms and subject to such conditions as the Court thinks just (Section 18, Assurance Companies Act, 1909). In such cases the time for ascertaining the rights of the assured is, as a general rule, the time when the petition for winding up the company is presented, and if a claim arises after that date, the assured is entitled to recover only the amount of his policy as reduced.

RIGHTS OF POLICY-HOLDERS AGAINST THE DEPOSIT

The life assurance and employers' liability insurance deposits, whether made specifically in the first instance or constituted subsequently by transfer, are security for the life and employers' liability policy-holders respectively, but not for any other class of policy-holders, and, subject to the claims of the life and employers' liability policy-holders, form part of the general assets of the company. The statutory deposit made by a fire company forms part of the assets of the company and, in the absence of any special provision in the policy, the policy-holders have no preferential claim upon it.

It is interesting to note that as regards the deposit of £15,000 under Section 42 of the Road Traffic Act, 1930, it has been held by the Court of Appeal (November, 1934) in *Re South-East Lancashire Insurance Co. Ltd.* that such deposits formed part of the general assets of the company available for distribution among all its creditors. This judgment is based on the fact that as Section 32 (*d*) of the Act of 1909 applied to motor vehicle business the same as it did to accident business, *vide* Road Traffic Act, 1930, the duty of keeping separate funds was thereby abrogated and accordingly the provision of Section 3 (2) of the Act of 1909 did not apply.

CHAPTER XII

INSURANCE UNDERTAKINGS BILL

UP to the present the recommendations contained in the Undertakings Bill have not been implemented by legislation, but a few comments thereon will indicate some of the modifications in the Assurance Companies Act, 1909, which the Committee deem it advisable to propose.

Arising out of the failure of the City Equitable Assurance Co., Ltd., and its allied companies, the Board of Trade, in July, 1924, appointed a Committee to inquire and report what amendments were desirable in the Assurance Companies Act, 1909. In 1927 the Committee issued their Report embodying their suggestions in the form of a Bill called the Insurance Undertakings Bill. Several of the Committee's proposals have already been legalized by the subsequent passing of the Companies Act, 1929, and the Road Traffic Act of 1930. Among the more important recommendations contained in the Bill are: (1) the creation of Statutory Funds for life, annuity, continuous disability, capital redemption, employers' liability and industrial assurance business, the assets of which funds are to be earmarked and kept distinct and separate from the company's other assets, and are to be available only for the liabilities appertaining to the business for which the fund was established. Further, the income arising from the investments representing the assets of any statutory fund, except the employers' liability statutory fund, is to be carried to that fund; (2) companies transacting reinsurance business only are exempt from the provisions of the Act, except companies doing life, annuity, continuous disability or industrial reinsurance business only; (3) marine and motor insurance business are to be brought within the scope of the Act. Of course, the Road Traffic Act, 1930, has already forestalled the Act so far as motor business is concerned.

ACCOUNTS AND BALANCE SHEET

The forms in which the accounts and Balance Sheet of insurance companies are to be presented are included in the Second, Third,

and Fourth Schedules to the Bill, and it is interesting to note that the usual commercial practice of showing the income on the right-hand side and the outgo on the left-hand side is adopted for both the Revenue and the Profit and Loss Accounts; also in addition to the Profit and Loss Account an Appropriation Account has to be furnished.

BALANCE SHEET, FORM "A"

The specimen Balance Sheet is a columnar one showing the assets and the liabilities of the Statutory Funds separately and, anticipating the Companies Act, 1929, calls for the publication of the authorized, subscribed and called-up capital.

Every combined Balance Sheet must show clearly on the face thereof that it is a combined Balance Sheet and must set out fully the name of every insurer whose assets and liabilities have been incorporated therein.

Deposits made outside Great Britain must be mentioned and, if forming part of a Statutory Fund, must be stated in detail.

If the book value of the investments in stocks and shares is greater in the aggregate than the market value thereof, the market value must be shown against the book value.

Investments in and loans to controlled companies are to be dealt with specially. This is already provided for in the Companies Act, 1929.

Contingent liabilities are to be shown.

Amounts due from directors and officials, unless fully secured, are to be shown separately. This differs somewhat from the provisions of the Companies Act, 1929, regarding this matter.

The following certificates, signed by the same persons as are required to sign the Balance Sheet, must be included in every Balance Sheet—

(1) A certificate indicating how the book values of the investments in stocks and shares have been arrived at, and how the market values thereof have been ascertained for the purpose of comparison with such book values.

(2) A certificate to the effect that the values of all the assets have been reviewed as at the date of the Balance Sheet and, that, in the belief of the signatories, they are shown in the aggregate at amounts not exceeding their realizable or market value under the various headings. Where "Reversions" and "Life Interests" are included, these

must be certified by an actuary. If the signatories are unable to give such a certificate, then a full explanation of the bases upon which the values shown in the Balance Sheet have been assessed shall be given in the certificate.

(3) A certificate stating that no part of the assets of any Statutory Fund has been applied directly or indirectly in contravention of the provisions of the Act relating to the application and investments of Statutory Funds. This certificate must also be signed by the auditor.

In addition to any certificate, or report, which the auditor is required to give by law, he must certify—

(a) That he has verified the cash balances and the securities relating to loans, reversions and life interests and investments.

(b) To what extent he has verified the investments and transactions relating to any trusts undertaken by the company as trustees.

(c) In the case of a combined Balance Sheet, that he has audited the Balance Sheet and accounts of the constituent companies or that they have been certified by independent auditors. Any reservations made by any auditor of a subsidiary company must be referred to in the auditors' report.

PROFIT AND LOSS ACCOUNT, FORM " B "

It is laid down that this account and the Appropriation Account must be income and expenditure accounts, not receipts and payments accounts.

The income tax deducted from interest, dividends and rents must be the total of both that deducted at source and that payable on assessment.

The net interest in the Profit and Loss Account may be the total interest less that applicable to the Statutory Funds, excluding the employers' liability interest, which latter may also be included in the Profit and Loss interest.

It is worthy of comment that, in addition to providing for the actual profits and losses on realization of investments, the *pro forma* Profit and Loss Account includes specific items for depreciation and appreciation of investments.

PROFIT AND LOSS APPROPRIATION ACCOUNT, FORM " C "

Contrary to the practice of those companies which make provision in their accounts for the final dividend before it has been passed by the members at the annual meeting, the Appropriation Account provides for any dividend in respect of the previous year paid

after the close of the year being shown in the subsequent year's Appropriation Account.

REVENUE ACCOUNTS, FORMS "D," "E," "F," AND "G"

Every class of business which requires the maintaining of a Statutory Fund must have a separate Revenue Account prepared for it. A separate Revenue Account must be prepared for fire business; motor vehicle, personal accident, burglary, fidelity guarantee, surety, live stock, public liability, plate glass, baggage, boiler and engineering, hail, and insurance against the liability of employers (other than employers' liability business) may be included in one Revenue Account. So far as motor vehicle business is concerned a separate account is now required under the Road Traffic Act, 1930.

Any combined Revenue Account must indicate thereon that it is a combined Revenue Account.

Where a company owns office premises, which form part of the assets of a Statutory Fund, a fair rent must be charged and debited to "Expenses of Management" and credited to "Interest, Dividends, and Rents."

Both income tax at source and on assessment must be deducted from the interest, dividends, and rents. In the case of the Revenue Accounts for those classes of business having a Statutory Fund, United Kingdom, Foreign and Dominion income tax must be deducted less any income tax recovered in respect of expenses of management, but in the case of any other class of business (including employers' liability business) only United Kingdom income tax is to be deducted.

Bad debts are to be shown as a separate item.

As opposed to the form provided for under the Assurance Companies Act, 1909, the form of Revenue Account for employers' liability business excludes from the fund both at the beginning and the end of the year the outstanding claims.

The claims items must include all expenses directly incurred in settling claims, and, in the case of fire business, must include contributions to fire brigades.

If in any year the provision for outstanding claims is underestimated, at the end of the following year the amount of such shortage must be shown in the Revenue Account.

The account for marine business is a hybrid combining certain features of both the Underwriting and the Revenue systems. The form is a columnar one giving the "Current Year," "Last Preceding Year," "Previous Years," and "Total," and in conformity with the underwriting system, no provision is made for outstanding claims, but the operations on what under the underwriting system (two years' basis) would be the Underwriting Suspense Account, are disclosed under their various denominations. Contrary to the general practice with accounts prepared on the Underwriting system, but in accordance with those formulated on the Revenue system, an item "Additional Reserve" is provided.

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